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Bank Financial Management

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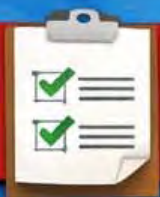


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CAIIB EXAMINATION 2026

Bank Financial Management

Chapterwise MCQ Bank

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CAIIB Bank Financial Management
Edition May 2026
Published by :NODIA
An Imprint of NODIA EDITIONS LLP

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MRP ₹730.00



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CHAPTER 01

Exchange Rates and Forex Business

May/June 2021

1. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below:
Assertion (A): High domestic interest rates tend to attract overseas capital, resulting in the home currency appreciating in the short term.
Reason (R): In the longer term, high interest rates slow the economy down, thereby weakening the home currency.
(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2008

2. Identify the correct responsibilities by matching the Treasury/Dealing Room functional offices in List-I with the descriptions in List-II:
List I: (Offices)
P. Front Office
Q. Mid Office
R. Back Office
S. Integrated Treasury (Broad Function)
List II: (Responsibilities)
1. Risk Management and Parameterization of risks
2. Meeting CRR and SLR requirements and Asset Liability Management
3. Settlement of deals and Reconciliation
4. Dealing in the Inter-Bank Market and Nostro Accounts
(A) P-4, Q-1, R-3, S-2
(B) P-1, Q-4, R-2, S-3
(C) P-4, Q-3, R-1, S-2
(D) P-2, Q-1, R-4, S-3

May/June 2012

3. Which of the following best describes the operational structure of the bulk of the foreign exchange markets globally?
(A) A physical marketplace operating through centralized exchange-traded systems with fixed trading floors.
(B) A system based on face-to-face out-cry on the floor of major global financial exchanges.
(C) An over-the-counter (OTC) market where trades occur via electronic communication systems.
(D) A localized network functioning only within the standard banking hours of each domestic country.

Oct/Nov 2023

4. Match the major risks associated with foreign exchange dealing operations in List-I with their descriptions in List-II:
List I: (Risks)
P. Operational Risk
Q. Exchange Risk
R. Systemic Risk
S. Legal Risk
List II: (Descriptions)
1. Arises mainly on account of fluctuations in exchange rates and/or when mismatches occur in assets/liabilities.
2. Possibility of a major bank failing causing losses to counter parties snowballing into a financial crisis.
3. Arises from human errors, technical faults, or lack of internal controls.
4. Arises on account of non-enforceability of contract against a counter party.
(A) P-3, Q-1, R-2, S-4
(B) P-1, Q-3, R-4, S-2
(C) P-3, Q-2, R-1, S-4
(D) P-4, Q-1, R-2, S-3

May/June 2005

5. Read the following scenario and answer the question that follows:

Using the given rates (USD/INR = 74.9500/9600 and GBP/USD = 1.3670/80), the dealer computes the buying rate for GBP against INR. What represents the correct underlying bid/offer logic the quoting bank is executing when calculating this buying rate?

- (A) The bank is willing to buy USD at 74.9600 and buy GBP at 1.3680.
- (B) The bank is willing to buy USD at 74.9500 and buy GBP at 1.3670.
- (C) The bank is willing to sell USD at 74.9600 and sell GBP at 1.3680.
- (D) The bank is willing to sell USD at 74.9500 and buy GBP at 1.3670.

Oct/Nov 2015

6. Identify the incorrect pair connecting derivative instruments and their application objectives:
- (A) Speculation - Taking a market position with the primary expectation of generating a profit.
 - (B) Speculation - Using derivatives to lock in costs and eliminate counterparty credit risk.
 - (C) Hedging - Reducing the risks associated with the everyday management of corporate cash flows.
 - (D) Hedging - Using an instrument to protect against adverse price movements in an underlying asset.

May/June 2019

7. According to the Foreign Exchange Management Act (FEMA), 1999, which of the following is strictly included in the definition of "Foreign Exchange"?
- (A) All deposits, credits, and balances payable in Indian currency held by domestic financial institutions.
 - (B) Drafts, cheques, and letters of credit expressed in Rupees but payable in foreign currency.
 - (C) Instruments payable at the drawer's option in local currency within the domestic market.
 - (D) Balances held in Indian currency with overseas banks for the purpose of trade settlement.

Oct/Nov 2007

8. What is the definition of Arbitrage as applied to foreign exchange?
- (A) Delaying fund payments to another center

to exploit interest rate differentials over time.

- (B) Simultaneous buying and selling in different markets to profit from price discrepancies.
- (C) Speculative purchasing of a currency based on the expected devaluation of the home currency.
- (D) Fixing exchange rates between two currencies via the medium of a specific third currency.

May/June 2025

9. Read the following scenario and answer the question that follows:

Bank Omega in Frankfurt buys EUR 1,000,000 from Bank Delta in New York at a value spot. Both centers are open on the settlement date. Bank Delta remits EUR 1,000,000 to Bank Omega first due to time zone differences. Before Bank Omega can remit the counter-value of USD 1,550,000 to Bank Delta when the USA market opens, Bank Omega fails and ceases operations. Bank Delta loses the EUR amount it already remitted and does not receive the USD amount.

Which specific risk did Bank Delta experience in this scenario?

- (A) Pre-settlement Credit Risk
- (B) Herstatt Risk
- (C) Operational Risk
- (D) Market Risk

Oct/Nov 2014

10. Arrange the following types of foreign exchange deals in the correct chronological order based on their settlement dates, from the earliest to the latest:

- I. Forward
- II. Ready or Cash
- III. Spot
- IV. Tom

- (A) II, IV, III, I
- (B) II, III, IV, I
- (C) IV, II, III, I
- (D) III, II, IV, I

May/June 2010

11. Consider the following statements comparing Forward Contracts and Futures Contracts:

- I. Forwards are of any size while Futures are standardized.
- II. Prices in a forward contract are determined by bid/ask quotes while prices in futures are

determined through an outcry or electronic trading platform.

Which of the statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2020

12. Exchange rates of all currencies are linked to various fundamental and technical factors. Which of the following is not considered a "Fundamental reason" influencing the movement of exchange rates?

- (A) The overall Balance of Payment (BOP) position.
- (B) The annualized economic growth rate of the nation.
- (C) Capital movements driven by specific government restrictions.
- (D) The prevailing national fiscal policy framework.

May/June 2006

13. What is the cardinal principle of operational procedure in the area of dealing room operations trading?

- (A) The clear functional segregation of the Front Office, Mid Office, and Back Office operations.
- (B) Maximizing speculative proprietary trading in foreign currencies to create a separate profit center.
- (C) Maintaining a single consolidated office for dealing, settlements, accounting, and reconciliation.
- (D) Allowing dealers exclusive control over gap positions and internal limit allocations without secondary oversight.

Oct/Nov 2018

14. Read the following scenario and answer the question that follows:

The corporate client inquires whether the exchange rate calculated will remain fixed over time or change. The dealer explains that India has adopted a floating exchange rate system. How is the value of the currency determined under this methodology?

- (A) The value is pegged to a trade-weighted basket of foreign currencies selected by the state.

- (B) The value is fixed by the monetary authority within specific upper and lower trading bands.

- (C) The value is driven by market supply and demand alongside inflation differentials.

- (D) The value is determined by the purchasing power parity limits set by the Central Bank.

May/June 2013

15. What is the most appropriate explanation of Gap Risk/Interest Rate Risk in the context of foreign exchange operations?

- (A) Risk of financial loss resulting from inadequate internal procedures or failed technical systems.

- (B) Risk that a foreign government prevents a counterparty from honoring specific contractual obligations.

- (C) Risk of price volatility in equity shares held within the treasury's investment portfolio.

- (D) Risk from adverse interest rate movements due to mismatches in forward value dates.

Oct/Nov 2009

16. What was the approximate global foreign exchange market daily turnover recorded in the year 2020?

- (A) USD 1.50 trillion
- (B) USD 5.00 trillion
- (C) USD 6.60 trillion
- (D) USD 34.00 billion

May/June 2024

17. Read the following scenario and answer the question that follows:

Bank Delta conducts an analysis of its maturity patterns of assets and liabilities. The bank finds that it has a significant mismatch where liabilities are draining at a faster rate than its liquid assets can cover, threatening its ability to fund its balance sheet in a sustainable way. However, it also observes areas where opportunities to invest and increase income are present without immediate threat.

When liquidity leads to a situation where there is no liquidity risk but opportunities to invest and increase income are less, what is this condition termed?

- (A) Positive liquidity gap
- (B) Negative liquidity gap
- (C) Forward differential gap
- (D) Interest rate gap

Oct/Nov 2025

18. In the foreign exchange market, what does a "Spot" deal specifically signify regarding the settlement of funds?
- (A) Settlement occurs on the same calendar day as the execution of the initial deal.
 - (B) Settlement occurs on the first working day immediately following the date of the deal.
 - (C) Settlement occurs on the second working day following the date of the deal.
 - (D) Settlement occurs on any date mutually agreed upon after the second working day.

May/June 2017

19. The broad functions of an Integrated Treasury encompass several critical areas. Which of the following is not one of the broadly defined functions of an Integrated Treasury?
- (A) Liquidity and funds management including analysis of major cash flows.
 - (B) Asset liability management, pricing of assets and liabilities in accordance with guidelines.
 - (C) Transfer pricing by providing benchmark rates to various business groups.
 - (D) Ensuring complete elimination of gap positions in all currencies on a daily basis.

Oct/Nov 2011

20. Consider the following statements regarding Exchange Arithmetic Overview:
- I. The chain rule is frequently applied while calculating the rate for non-US Dollar currencies against the INR.
 - II. A per mille is one part in every hundred parts, such as Rupee 1 per Rupees 100.
 - III. The value date for Telegraphic Transfers (TT) is usually the same in both centres, meaning payment of the respective currency in both centres takes place on the same day.
 - IV. Simple or direct arbitrage involves operations conducted through three or more centres and involving several currencies.
- Which combination of statements is correct?

- (A) I and II
- (B) II and IV
- (C) I and III
- (D) III and IV

May/June 2022

21. Consider the following statements about the characteristics of Futures Contracts:

- I. They are tailor-made contracts that are traded Over the Counter (OTC).
- II. Prices are determined based on the open outcry or on electronic trading platforms based on demand and supply.
- III. Settlement price is generated either through an outcry or Electronic Trading Platform.
- IV. The clearing house conducts the trade and guarantees the buyer and the seller the commitment on behalf of the related parties.

Which combination of statements is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

Oct/Nov 2006

22. Consider the following statements regarding the fundamental factors determining exchange rates:
- I. A surplus in the Balance of Payment (BOP) generally leads to a stronger home currency, while a deficit weakens the same.
 - II. A high economic growth rate leads to a rise in production and exports, subsequently causing a rise in the value of the home currency.

Which of the statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2015

23. Read the following scenario and answer the question that follows:
A corporate client approaches Bank Alpha in Mumbai to obtain a quote for GBP against INR. However, GBP is not quoted directly against INR in the domestic market. The bank's dealer notes that USD/INR is quoted at 74.9500/9600 in the domestic market, and GBP/USD is quoted at 1.3670/80 in the international market. The client wants to understand how the bank will compute the required rate.

Based on the scenario, which mechanism must the bank's dealer use to arrive at the GBP/INR rate?

- (A) Direct Quotation mechanism
- (B) Indirect Quotation mechanism
- (C) Chain Rule mechanism

(D) Cross Rate mechanism

Oct/Nov 2016

24. Read the following scenario and answer the question that follows:

Suppose instead that Bank Delta's counterpart was a state-owned entity in a different country that failed to fulfill its obligations. When Bank Delta initiated recovery proceedings, the entity claimed immunity from the proceedings because its state-owned status could not be questioned in a Court of Law.

Which risk is Bank Delta facing in this instance?

- (A) Liquidity Risk
- (B) Systemic Risk
- (C) Equity Price Risk
- (D) Sovereign Risk

May/June 2008

25. Which of the following accurately identifies a reason for the evolution of an Integrated Treasury compared to conventional treasury and dealing room operations?

- (A) Increased regulations on interest rates strictly separating domestic and forex markets.
- (B) Liberalization of exchange control and development of forex markets.
- (C) Tightening of exchange controls preventing cross-border capital flows.
- (D) Obsolescence of dealing environments and regression of settlement systems.

Oct/Nov 2013

26. Which of the following statements regarding the major participants in the foreign exchange market is incorrect?

- (A) Central Banks managing national reserves to minimize the volatility of their respective home currencies.
- (B) Commercial Banks offering currency exchange while hedging assets and speculating on rate movements.
- (C) Corporations moving capital across borders for trade, investment, or speculative currency activities.
- (D) Brokers acting as principals who assume the ultimate credit risk for every executed trade.

May/June 2023

27. Which of the following is an incorrect statement regarding the management and control of risks in a dealing room?

- (A) Deal confirmations from Nostro correspondents are only required annually to minimize operational overhead.
- (B) Every dealer should be advised of the limits allocated to them and work within those limits.
- (C) Overall position must be arrived at the end of the day and kept well within the NOOPL, AGL, and IGL.
- (D) Reconciliation of balances in the RBI accounts, Nostro, and Vostro accounts should be done periodically, say, at least once in a month.

Oct/Nov 2024

28. Consider the following statements regarding forward margins (Premium and Discounts):

- I. If the forward value of the home currency is cheaper than the present value (spot), the currency is said to be at a discount.
- II. The forward premium and discount are generally determined by the interest rate differentials of the two currencies involved.
- III. In a perfect market, if the US interest rate is 2% p.a. and the London interest rate is 4% p.a., there will be a demand for USD in the spot market to invest in UK bills.

Which combination of statements is correct?

- (A) I and II
- (B) II and III
- (C) I and III
- (D) I, II, and III

May/June 2011

29. Consider the following statements regarding the Internal Control Guidelines of RBI for dealing room operations:

- I. Access rules for performing distinct functions should be defined in detail and drawn up for persons unconnected with the dealing activities.
- II. Global limits for Inter-Bank deals are to be put in place strictly for domestic deals, excluding overseas transactions.
- III. Appropriate VAR models must be utilized for quantifying the extent of market risk for a given level of confidence.
- IV. All deals must be within the Net Overnight

Open Position Limits (NOOPL) and Individual GAP Limits (IGL).

- V. Evaluation of foreign exchange profits and losses must be done at the closing rates of every week as announced by FEDAI.

Which combination of statements is correct?

- (A) I, II, and IV
- (B) I, III, and IV
- (C) II, III, and V
- (D) I, IV, and V

Oct/Nov 2019

30. Identify the correct pair regarding exchange rate quotations:
- (A) Direct Quote - Local currency remains fixed while the number of units of foreign currency varies.
 - (B) Indirect Quote - Local currency is variable and is known directly as the cost of foreign currency.
 - (C) Indirect Quote - Globally used for all currencies in terms of USD without exceptions.
 - (D) Direct Quote - Also known as Home Currency or Price quotations.

May/June 2018

31. Read the following scenario and answer the question that follows:
The Financial Risk Manager suggests that ABC Ltd does not need to execute separate instruments for the principal risk, coupon risk, and interest rate risk. Instead, a single swap structure can be utilized to hedge all three risks simultaneously.
 Which swap provides this comprehensive hedging solution?
- (A) Principal Only Swaps (POS)
 - (B) Fixed-fixed Zero Coupon Swap
 - (C) Currency Coupon Swaps (CCS)
 - (D) Overnight Index Swap (OIS)

Oct/Nov 2010

32. According to FEDAI guidelines on clean instruments, if a beneficiary does not respond within a specific timeframe from the date of credit to the Nostro account, and the Bank does not return the funds to the remitter, the Bank shall crystallize the remittance. What is this timeframe?
- (A) 2 working days
 - (B) 5 working days
 - (C) 7 calendar days

- (D) 15 working days

May/June 2009

33. An option that would be profitable (excluding the cost of the premium), if exercised immediately, is referred to as:
- (A) At the Money (ATM)
 - (B) In the Money (ITM)
 - (C) Out of the Money (OTM)
 - (D) On the Money (OTM)

Oct/Nov 2017

34. The RBI issues specific guidelines for Authorized Persons regarding the operations and risk management of their assets/liabilities. Which of the following is not permitted for an AD Cat I Bank?
- (A) Opening rupee accounts for overseas branches (excluding Pakistan) without RBI reference.
 - (B) Opening and closing foreign currency accounts in their own name abroad to route transactions.
 - (C) Opening Rupee accounts for Exchange Houses to facilitate private remittances without RBI approval.
 - (D) Investing in money market instruments issued by a foreign state with maturity under one year.

May/June 2007

35. According to FEDAI Rule 1 regarding Hours of business, what are the normal market hours for transacting in FCY/INR on all working days?
- (A) 8.00 am to 4.00 pm
 - (B) 9.00 am to 5.00 pm
 - (C) 10.00 am to 6.00 pm
 - (D) Round the clock (24 hours)

Oct/Nov 2021

36. Consider the following statements regarding RBI/FEDAI guidelines on derivative limits and forward contracts:
- I. Banks can allow residents to book forward exchange contracts to hedge exchange risk exposure for permissible transactions under FEMA 1999.
 - II. Small and Medium Enterprises (SME) can book forward contracts to hedge direct or indirect exposures without production of the underlying.
 - III. The maturity of the forward contract

booked must safely exceed the tenor of the underlying transaction to ensure full coverage.

- IV. Banks can offer Interest Rate Swaps or Coupon Swaps to resident entities who have borrowed foreign exchange under FEMA.
- V. Banks can enter into cross currency options with their customers purely on a back-to-back basis.

Which combination of statements is correct?

- (A) I, II, IV, and V
- (B) I, II, III, and IV
- (C) II, III, IV, and V
- (D) I, III, IV, and V

May/June 2014

37. Under a foreign exchange options contract, what rights do the Call Option and the Put Option give to the buyer respectively?
- (A) Call Option gives the right to purchase the currency; Put Option gives the right to sell the currency.
 - (B) Call Option gives the right to sell the currency; Put Option gives the right to purchase the currency.
 - (C) Both Call and Put Options give the obligation, rather than the right, to purchase and sell respectively.
 - (D) Call Option guarantees a fixed future exchange rate; Put Option allows swapping principal amounts.

Oct/Nov 2005

38. Read the following scenario and answer the question that follows:
Suppose Bank Zenith experiences a delay in the payment of the inward remittance to the customer. The payment is made 4 days after the date of credit to the Nostro account. According to FEDAI guidelines, compensation for delayed payment must be paid for the delayed period.
 What is the prescribed interest rate for this compensation?
- (A) 1% over the Repo rate as announced by the Reserve Bank.
 - (B) 2% over the MIBOR rate for inter-bank overnight transactions.
 - (C) 5% over the base rate of the Bank as applicable at that time.
 - (D) 2% over the prevailing Savings Bank interest rate.

May/June 2016

39. Match the currencies in List-I with their respective benchmark rates used for calculating interest for delayed delivery under Inter-Bank Settlements (Rule 8) in List-II:

List I: (Currencies)

- P. INR
- Q. USD
- R. CHF
- S. EUR

List II: (Benchmark Rates)

- 1. Base rate of Citi Bank
 - 2. Marginal lending rate of the ECB
 - 3. MIBOR
 - 4. Base rate of Swiss National Bank
- (A) P-1, Q-3, R-2, S-4
 - (B) P-3, Q-1, R-4, S-2
 - (C) P-3, Q-4, R-1, S-2
 - (D) P-4, Q-1, R-3, S-2

Oct/Nov 2012

40. Match the Authorized Dealer Categories/Entities in List-I with their corresponding examples in List-II:

List I: (Categories)

- P. Authorized Dealer – Category I
- Q. Authorized Dealer – Category II
- R. Authorized Dealer – Category III
- S. Full Fledged Money Changer

List II: (Examples)

- 1. Exim Bank, SIDBI
 - 2. Commercial banks, State and Urban Cooperative Banks
 - 3. Upgraded FFMCS, Regional Rural Banks
 - 4. Other FFMCS, Dept of Post
- (A) P-2, Q-3, R-1, S-4
 - (B) P-1, Q-4, R-3, S-2
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-2, Q-4, R-1, S-3

May/June 2020

41. Identify the incorrect pair linking the type of customer remittance to the corresponding Bank transaction:
- (A) Inward Remittance - Bank buys foreign exchange (Purchase transaction)
 - (B) Realization of Export Bills - Bank sells foreign exchange (Sale transaction)
 - (C) Outward Remittance - Bank sells foreign exchange (Sale transaction)
 - (D) Payment of Import Bills - Bank sells foreign exchange (Sale transaction)

Oct/Nov 2022

42. Read the following scenario and answer the question that follows:

ABC Ltd, a Large Corporate, has been sanctioned an External Commercial Borrowing (ECB) of USD 100 Million by IFC, Washington. The loan is repayable over 5 years in yearly installments due on 31st Dec each year starting from 2021. The interest rate is SOFR + 400 BPs with SOFR reset every year. The company intends to draw down the entire amount immediately for rupee expenditure in India and approaches its Financial Risk Manager to mitigate the associated risks.

How can ABC Ltd effectively mitigate the “Principal risk” of USD 20 Million per year?

- (A) Entering into a Zero Coupon Swap for the entire maturity period of the loan.
- (B) Purchasing European Call Options on the SOFR rate for the duration of the debt.
- (C) Executing Principal Only Swaps (POS) to book long-term forward contracts.
- (D) Investing in domestic equity markets to generate returns that offset currency losses.

Oct/Nov 2009

43. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below:

Assertion (A): Under FEDAI Rule 5 for Foreign Exchange Contracts, the customer (buyer or the seller) will always have the option of delivery.

Reason (R): Option period of delivery shall not exceed beyond 1 month.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2016

44. Consider the following statements pertaining to FEDAI Rule 2 – Export transactions:

- I. Post shipment finance (Purchase/Discount/negotiation) applies the Bill buying rate.
- II. Normal Transit Period (NTP) for sight bills is uniformly 30 days for all currencies.
- III. Early realization of an export bill requires the interest for the unexpired period to be

refunded to the Exporter.

- IV. Bills drawn under LC must claim TT reimbursement within 5 days from the date of handling the Export bill.
- V. Dishonor of bills is settled at the TT selling rate along with the interest till the date of dishonour.

Which combination of statements is correct?

- (A) I, II, IV, and V
- (B) I, III, IV, and V
- (C) II, III, IV, and V
- (D) I, II, III, and V

Oct/Nov 2018

45. Up to what limit can banks allow resident individuals to book forward contracts without the production of underlying documents, provided the contracts are normally on a deliverable basis and tenors up to one year?

- (A) USD 10,000
- (B) USD 50,000
- (C) USD 100,000
- (D) USD 1,000,000

May/June 2023

46. The pricing of an option combines five elements. Which of the following is strictly one of those five elements?

- (A) Historical performance of the specific asset over the previous ten-year period.
- (B) Volatility, defined as the standard deviation between spot and forward rates.
- (C) The credit rating of the counterparty involved in the specific derivative contract.
- (D) The size of the dealing room’s overall gap position at the end of the day.

Oct/Nov 2025

47. The FX Global Code aims at several key objectives for wholesale foreign exchange markets. Consider the following objectives:

- I. Principles of good practices
- II. Engaging local participants actively
- III. Promoting healthy & disciplined dealing room trading

Which combination correctly represents these aims?

- (A) Only I and II
- (B) Only II and III
- (C) Only I and III
- (D) I, II, and III

May/June 2007

48. The Reserve Bank of India categorizes Authorized Dealers based on their level of authority to undertake a variety of transactions. Which of the following correctly describes Authorized Dealer – Category III?
- (A) Entities authorized to handle all current and capital account transactions per RBI directions.
 - (B) Institutions dealing in forex incidental to international trade financing (e.g., Exim Bank).
 - (C) Entities authorized to deal in foreign exchange transactions that are purely of a non-trade nature.
 - (D) Entities authorized solely for the purchase and sale of forex for private visits abroad.

Oct/Nov 2014

49. Under FEDAI Rule 6 – Early delivery, extension, and cancellation, which of the following is the correct statement regarding automatic cancellation of contracts?
- (A) Automatic cancellation by the Bank occurs on the third day following the maturity date.
 - (B) Automatic cancellation by the Bank occurs on the fifteenth day from the maturity date.
 - (C) The Bank must obtain prior RBI approval before cancelling any unutilized forward contracts.
 - (D) Automatic cancellation requires all accrued profits to be passed on to the customer.

May/June 2012

50. Read the following scenario and answer the question that follows:
A resident customer of Bank Zenith receives an inward remittance in foreign exchange through the Nostro channel. The beneficiary is required to execute the inward remittance according to FEDAI Rule 4 regarding Clean Instruments. Within how many calendar days must the surrender of the foreign exchange to the Bank occur?
- (A) 3 calendar days
 - (B) 5 calendar days
 - (C) 7 calendar days
 - (D) 15 calendar days

Oct/Nov 2006

51. Which of the following accurately describes the banking concept of Purchase and Sale transactions in foreign exchange arithmetic?
- (A) Inward remittances are sales for the bank, while outward remittances are purchases.
 - (B) Purchase refers to buying home currency from the RBI, and sale is selling to the RBI.
 - (C) Transactions are defined solely from the point of view of the customer, not the bank.
 - (D) Inward remittances are purchase transactions, and outward remittances are sale transactions.

May/June 2019

52. Read the following scenario and answer the question that follows:
ABC Ltd is also exposed to “Interest rate risk” due to fluctuations in the SOFR rates over the next 5 years, as the ECB is availed on a floating rate concept.
 Which instrument should the Corporate use specifically to mitigate this interest rate risk?
- (A) Equity Swaps involving the exchange of dividend returns for fixed interest payments.
 - (B) Coupon Only Swaps (COS) which focus solely on the exchange of interest payments.
 - (C) Basis Swaps involving the exchange of two distinct floating rates with different indices.
 - (D) Interest Rate Swaps (IRS) where the entity pays fixed and receives floating rates.

Oct/Nov 2021

53. FEDAI undertakes multiple roles in the Indian Foreign Exchange Market. Which of the following is not one of the important objectives or roles of FEDAI?
- (A) Issuing guidelines on various aspects relating to Foreign Exchange.
 - (B) Administering benchmark rates such as Month end revaluation rates and daily USD/ INR closing rates for NOOP calculation.
 - (C) Acting as the central counterparty clearing house for settling all domestic equity derivatives.
 - (D) Granting accreditation to Intermediaries viz., Brokers, electronic service providers, etc.

May/June 2010

54. Under FEDAI Rule 8 regarding Inter-Bank Payments and Settlements, what is the most

appropriate action a bank must take in the event of “undue enrichment of funds”?

- (A) The bank is permitted to retain the enriched funds as a market making profit.
- (B) The bank must transfer the funds immediately to the Investor Education and Protection Fund (IEPF).
- (C) The bank is required to return the funds to the counterparty with interest.
- (D) The bank must adjust the funds against future forward premiums.

Oct/Nov 2011

55. Read the following scenario and answer the question that follows:

In another transaction, Bank Zenith transfers funds from a Vostro account to another bank's account for a beneficiary. Bank Zenith delays submitting Form A3 to the beneficiary bank beyond 5 days from the date of credit.

What is the penalty structure for this delay according to FEDAI Rule 4?

- (A) Rs. 1,000 per day, capped at Rs. 10,000 per instance.
- (B) Rs. 500 per day, capped at Rs. 5,000 per instance.
- (C) Rs. 2,000 per day with no cap.
- (D) 2% of the remittance amount, capped at Rs. 50,000.

May/June 2005

56. Consider the following statements regarding types of SWAPS:

- I. An Interest Rate Swap is a contractual agreement where cash flows at a fixed rate are exchanged for those referenced to a floating rate, with a physical exchange of principal amounts.
- II. A Currency Swap involves cash flows in one currency being exchanged for cash flows in another currency, offering an efficient way to hedge forex risk and interest rate risk simultaneously.
- III. A Zero Coupon Swap can be structured such that the fixed rate cash flows are paid just once at the end of the maturity of the swap contract.

Which combination of statements is correct?

- (A) I and II
- (B) II and III
- (C) I and III
- (D) I, II, and III

Oct/Nov 2022

57. Consider the following statements regarding the utilization of NOSTRO accounts by banks:

- I. All borrowings of banks, including ECB, and temporary overdrafts in NOSTRO accounts not adjusted within five days, shall not exceed 50% of their unimpaired Tier 1 capital or USD 10 million, whichever is higher.
- II. Overseas borrowings for the purpose of extending export credit in foreign currency are explicitly included as part of the above 50% ceiling.

Which of the statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2018

58. Which of the following best describes the fundamental nature of the Foreign Exchange Dealers Association of India (FEDAI)?

- (A) A Self-Regulatory Organization formed in 1958 to regulate the dealings of Authorized Dealers.
- (B) An autonomous commercial bank that competes with Authorized Dealers in the foreign exchange market.
- (C) A governmental law enforcement agency responsible for the direct prosecution of FEMA violations.
- (D) An international clearing house that guarantees all forward contracts executed by Indian residents.

Oct/Nov 2016

59. Consider the following statements about Business Intermediaries as per FEDAI Rule 7:

- I. Exchange brokers, multi-bank portals (MBPs), and electronic order matching systems (EOMS) are commonly used intermediaries.
- II. All business intermediaries must be accredited by FEDAI.
- III. For MBPs and EOMS, RBI authorization is mandatory.
- IV. All contracts/confirmations must explicitly exclude the clause “Subject to Rules and Regulations of FEDAI” to maintain market neutrality.

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Which combination of statements is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

May/June 2014

60. Regarding FEDAI Rule 3 – Import transactions, which of the following statements is incorrect?
- (A) The application of exchange rate for the retirement of Import bills uses the Bill selling rate.
 - (B) The crystallization of Import bills is executed applying the TT buying rate.
 - (C) Bills under Negotiation under LCs attract commercial rate of interest as applicable to the Bank's domestic advances from time to time.
 - (D) Unpaid import bills drawn under LCs are crystallized as per the Bank's policy.

Oct/Nov 2007

61. An exporter customer tenders an export bill for USD 500,000. The spot rate for USD/INR is 75.14/15. The premium is calculated at 0.4500 (45 paise). The bank applies an exchange margin of 0.15% to be loaded on the spot buying rate. Using the rule to deduct the margin for buying, what is the spot rate after deducting the 0.15% margin (before adding premium)?
- (A) 75.2527
 - (B) 75.1400
 - (C) 75.0270
 - (D) 75.5900

May/June 2025

62. Swaps serve specific purposes based on varying factors. Which of the following is not a factor typically influencing SWAPS?
- (A) The need to bypass the Bank's Net Overnight Open Position Limit.
 - (B) Changes in investment objectives or the specific repayment scenarios of the entity.
 - (C) Increased financial benefits in switching to alternative available cash flow streams.
 - (D) The need to mitigate risks associated with a floating rate loan repayment schedule.

Oct/Nov 2013

63. According to extant regulatory guidelines, inward remittances may be received for several purposes. Consider the following purposes:

- I. Remittances towards realization of Export of goods.
- II. Remittances from Overseas donors towards foreign contributions under FCRA.
- III. Remittances by resident individuals to Overseas beneficiaries for family maintenance.
- IV. Remittances from Overseas Investors into the equity of Indian entities (FDI).

Which combination of statements is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, II, and IV
- (D) I, III, and IV

May/June 2008

64. Which of the following statements correctly dictates the procedure for the cancellation of an existing forward purchase contract?
- (A) A forward purchase contract must be cancelled at the opposite TT selling rate.
 - (B) A forward purchase contract must be cancelled at the original TT buying rate regardless of markets.
 - (C) It must be cancelled at the Bill buying rate applicable on the maturity date without adjustments.
 - (D) A forward purchase contract can only be cancelled after obtaining explicit permission from FEDAI.

Oct/Nov 2005

65. Identify the correct pair concerning the applicable exchange rate for an inward remittance received by the Bank:
- (A) Foreign exchange received by TT in the Nostro account – Bank applies TC Buying rate.
 - (B) Foreign exchange received in the form of Currency Notes – Bank applies TT Buying rate.
 - (C) Foreign exchange received by TT in the Nostro account – Bank applies TT Buying rate.
 - (D) Foreign exchange received in the form of Traveller's Cheques – Bank applies Currency Selling rate.

May/June 2017

66. Consider the following statements regarding the role of FEDAI:
- I. FEDAI articulates India's viewpoint in

various revisions in ICC ground rules like UCP, URC, URDG, etc.

- II. FEDAI administers benchmark rates, including month-end revaluation rates for foreign exchange positions.
- III. FEDAI directly regulates the domestic monetary policy by setting the Cash Reserve Ratio (CRR).

Which combination of statements is correct?

- (A) I and II
- (B) II and III
- (C) I and III
- (D) I, II, and III

Oct/Nov 2015

67. Consider the following steps/elements involved in calculating the forward rate for a forward purchase contract for an export bill:

- I. Determine the applicable Spot interbank buying rate.
- II. Identify the forward premium for the delivery period matching the customer's option.
- III. Deduct the exchange margin from the computed forward interbank rate.
- IV. Add the margin to the forward interbank rate.
- V. Pass on the forward margin for the period prior to the start of the delivery period.

Which combination accurately reflects the correct steps and rules to be used?

- (A) I, II, III, and V
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

May/June 2013

68. Read the following scenario and answer the question that follows:

A bank needs to calculate the rate for an inward remittance value spot. The Inter-Bank Spot USD/INR rate is quoted as 75.0050/75.0075. The bank assumes a margin of 0.1000 (10 paise) over the Inter-Bank rate.

What is the final rate calculated for the customer for this inward remittance?

- (A) 75.1050
- (B) 74.9050
- (C) 75.1075
- (D) 74.9075

Oct/Nov 2010

69. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below:

Assertion (A): When computing the rate for GBP/INR, dealers in India usually rely on the cross rate mechanism using USD/INR and GBP/USD.

Reason (R): In the Indian domestic market, straight rates are actively available primarily for USD/INR, making direct quotes for other currency pairs less available.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2009

70. Match the FEDAI Rules in List-I with their respective subjects in List-II:

List I: (FEDAI Rules)

- P. Rule 2
- Q. Rule 3
- R. Rule 4
- S. Rule 5

List II: (Subjects)

- 1. Clean Instruments
- 2. Foreign Exchange Contracts
- 3. Export transactions
- 4. Import transactions

- (A) P-3, Q-4, R-1, S-2
- (B) P-4, Q-3, R-2, S-1
- (C) P-1, Q-2, R-3, S-4
- (D) P-3, Q-1, R-4, S-2

Oct/Nov 2017

71. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below:

Assertion (A): When a Bank receives a request from a customer to make an outward remittance to an overseas supplier, the Bank applies the TT Selling rate.

Reason (R): The Bank is effecting a sale of foreign exchange to the customer, converting the customer's rupees into foreign currency.

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- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2015

72. When a customer requests the retirement of an import bill denominated in GBP, and the bank must use Cross Rates (using GBP/USD and USD/INR), what is the most appropriate logic the bank must follow to arrive at the final Bill Selling Rate for GBP/INR?
- (A) Sell GBP against USD and sell USD against INR, then multiply rates and subtract the margin.
 - (B) Buy GBP against USD and sell USD against INR, then divide the rates and add the margin.
 - (C) Sell GBP against INR directly using the central bank mid-rate without using any cross rates.
 - (D) Buy GBP against USD and buy USD against INR, then add the required margin.

Oct/Nov 2012

73. Consider the following statements regarding Derivative Products in the Forex Market:
- I. A derivative is a financial product whose value is derived from the value of another underlying asset or exposure.
 - II. Futures are tailor-made contracts that are not traded on an organized Exchange.
 - III. Forward contracts are useful to hedge future receivables or future payables.
 - IV. In an Option contract, the Buyer of the Option is called the holder while the Seller is referred to as the writer.
 - V. Basis Swaps involve a regular exchange of cash flows where both legs are calculated on floating interest rates.
- Which combination of statements is correct?
- (A) I, II, III, and IV
 - (B) I, III, IV, and V
 - (C) II, III, IV, and V
 - (D) I, II, IV, and V

May/June 2011

74. Consider the following characteristics regarding SWAPS:
- I. They represent an agreement between two parties to exchange a series of cash flows over a specific period of time.
 - II. They are strictly traded on organized futures exchanges rather than over-the-counter.
 - III. They offer great flexibility in designing and structuring contracts based on mutual agreement.
 - IV. In an interest rate swap, there is no exchange of the principal amounts; only the cash flows based on the notional amount are exchanged.
- Which combination of statements is correct?
- (A) I, II, and III
 - (B) I, III, and IV
 - (C) II, III, and IV
 - (D) I, II, and IV

Oct/Nov 2020

75. Read the following scenario and answer the question that follows:
- The same bank now needs to calculate the rate for an outward remittance value spot using the same Inter-Bank Spot USD/INR quote of 75.0050/75.0075. The margin to be applied remains 0.1000.*
- What is the final rate calculated for the customer for this outward remittance?
- (A) 75.1075
 - (B) 75.1050
 - (C) 74.9050
 - (D) 74.9075

May/June 2022

76. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below:
- Assertion (A): For a sale forward contract with an option period, the premium for the full period, up to the end date of the contract, shall be charged to the customer.
- Reason (R): In a sale contract, the bank must cover its maximum risk; hence it charges premium for the longest possible delivery date the customer might choose.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

77. What is the most appropriate action taken by a Bank when foreign exchange is sold to a customer in the form of Currency Notes?
 (A) The Bank applies the TT Selling rate with no margins.
 (B) The Bank applies the Bill Selling rate to cover the transit period.
 (C) The Bank applies the Currency Notes selling rate.
 (D) The Bank credits the rupee equivalent to the Nostro account directly.

May/June 2024

78. Outward remittances are permissible under extant regulatory guidelines for specific purposes. Consider the following purposes:
 I. Repatriation of balances in Non-resident External Accounts (NRE).
 II. Remittances towards settlement of Import bills for goods already received.
 III. Remittances towards advance payments for exports to be sent out of India.
 Which combination of statements is correct?
 (A) I and II
 (B) II and III
 (C) I and III
 (D) I, II, and III

Oct/Nov 2013

79. Consider the following statements regarding the treatment of premiums in forward contracts:
 I. For a merchant sale forward booking transaction, the premium payable is added to the Spot interbank selling rate to arrive at the IB forward rate.
 II. For a forward purchase contract, the forward premium is passed on to the customer only up to the beginning of the contract period (start date of the option).
 Which of the statements is/are correct?
 (A) Only I
 (B) Only II
 (C) Both I and II
 (D) Neither I nor II

May/June 2020

80. Regarding FEDAI Rule 5 on Foreign Exchange Contracts, which of the following is an incorrect statement?
 (A) All merchant transaction rates are strictly rounded to the nearest 10 paise.
 (B) Contracts must be for definite amounts and defined periods of delivery.
 (C) If a fixed date falls on a holiday, the delivery occurs on the preceding working day.
 (D) The customer has the option of delivery in an option delivery contract.

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ANSWERS

1. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
High interest rates attract foreign capital because investors seek higher returns, leading to increased demand for the domestic currency and its appreciation in the short term. Conversely, prolonged high interest rates increase borrowing costs, which can slow economic growth. This long-term slowdown typically weakens the home currency. These two phenomena occur independently of each other.
2. (A) P-4, Q-1, R-3, S-2
The treasury function is divided into specialized departments to ensure efficient management and control. The front office handles market dealing and position management, while the mid office focuses on risk assessment and limit monitoring. The back office manages the final settlement and reconciliation of trades. Integrated treasury functions oversee broader institutional requirements such as liquidity and asset-liability management.
3. (C) An over-the-counter (OTC) market where trades occur via electronic communication systems.
Unlike equity markets that utilize centralized exchanges, the global foreign exchange market operates as a decentralized network. Most trading occurs over-the-counter through electronic systems, telephones, and computer terminals connecting participants worldwide. This structure allows for continuous, twenty-four-hour trading across different time zones, making it the largest and most liquid financial market in the world's economic system.
4. (A) P-3, Q-1, R-2, S-4
Foreign exchange operations involve diverse risks that require meticulous management. Operational risk stems from internal failures, while exchange risk relates to rate volatility. Systemic risk involves the potential for a single failure to disrupt the entire financial network. Legal risk arises when contracts cannot be enforced. Understanding these distinctions is vital for maintaining the stability of bank dealing operations.
5. (B) The bank is willing to buy USD at 74.9500 and buy GBP at 1.3670.
Calculating a cross-buying rate involves two distinct legs where the bank must apply the bid rates for both involved pairs. For a GBP/INR buying rate, the bank buys US Dollars with Indian Rupees and simultaneously buys Great Britain Pounds using those Dollars. Therefore, the bank utilizes the lower bid rates of 74.9500 for USD and 1.3670 for GBP.
6. (B) Speculation - Using derivatives to lock in costs and eliminate counterparty credit risk.
Derivatives are financial instruments used for distinct financial objectives. Speculation involves taking intentional market positions to profit from anticipated price movements, accepting risk rather than eliminating it. Hedging is the process of using derivatives to reduce or offset existing risks, such as currency or interest rate fluctuations. Eliminating counterparty credit risk is generally achieved through collateralization or clearinghouse guarantees.
7. (B) Drafts, cheques, and letters of credit expressed in Rupees but payable in foreign currency.
Under the Foreign Exchange Management Act of 1999, the definition of foreign exchange is broad and includes various financial instruments. It encompasses deposits and balances payable in foreign currency, along with drafts, cheques, and letters of credit that are denominated in Indian Rupees but are ultimately payable in a foreign currency. This ensures comprehensive regulation of cross-border financial settlements.
8. (B) Simultaneous buying and selling in different markets to profit from price discrepancies.
Arbitrage in foreign exchange refers to the practice of taking advantage of price differences for the same currency in different markets. By simultaneously buying a currency where the price is lower and selling it where the price is

higher, a dealer can lock in a risk-free profit. This activity helps maintain price consistency across global financial trading centers.

9. (B) Herstatt Risk

Herstatt risk is a specific type of settlement risk that occurs when there is a time zone difference between two settlement centers. It arises when one party delivers the currency it sold but fails to receive the currency it bought because the counterparty fails before completing its side of the transaction. This risk was famously highlighted by the 1974 failure.

10. (A) II, IV, III, I

Foreign exchange deals are categorized by their settlement dates relative to the transaction date. Ready or Cash deals settle on the same day. Tom deals settle on the next working day. Spot deals settle on the second working day after the deal. Any transaction where the settlement occurs after the spot date is classified as a forward contract for delivery.

11. (C) Both I and II

Forward and futures contracts are both derivatives used to manage risk, but they differ in structure. Forward contracts are private, customizable agreements traded over-the-counter with prices set by bid-ask quotes. In contrast, futures contracts are standardized in size and maturity, trading on organized exchanges where prices are determined through transparent electronic platforms or open outcry systems for participants.

12. (C) Capital movements driven by specific government restrictions.

Fundamental factors influencing exchange rates are broad economic indicators that reflect a nation's financial health. These include the balance of payments position, economic growth rates, fiscal policy, and inflation. While government restrictions on capital movements certainly impact exchange rates, they are categorized as technical or political factors rather than fundamental economic drivers of long-term currency value and strength.

13. (A) The clear functional segregation of the Front Office, Mid Office, and Back Office operations. The cardinal principle of dealing room operations is the strict segregation of duties between different

functional areas. This separation ensures that the individuals who execute trades are different from those who manage risk and those who settle transactions. Such a structure prevents fraud, reduces operational errors, and ensures that internal controls and independent oversight are maintained during daily operations.

14. (C) The value is driven by market supply and demand alongside inflation differentials.

In a floating exchange rate system, the value of a currency is not fixed by the government or pegged to a basket. Instead, it is determined by the continuous interaction of market forces, specifically the supply and demand for that currency. Factors such as inflation differentials, interest rate changes, and overall economic performance influence these market-driven valuations and movements.

15. (D) Risk from adverse interest rate movements due to mismatches in forward value dates.

Gap risk, often referred to as interest rate risk in forex, arises when there is a mismatch in the maturity dates of assets and liabilities. This occurs when a bank has forward purchases and sales that do not align perfectly in time. Adverse movements in interest rates during these intervals can lead to financial losses when closing the resulting gap positions.

16. (C) USD 6.60 trillion

The foreign exchange market is characterized by immense liquidity and high transaction volumes. According to data recorded in 2020, the average daily turnover reached approximately 6.6 trillion US dollars. This massive scale highlights the market's role as the primary venue for global trade settlement, investment flows, and speculative activity, far exceeding the volumes found in traditional equity markets.

17. (A) Positive liquidity gap

A positive liquidity gap occurs when a financial institution's maturing assets exceed its maturing liabilities. While this indicates a strong liquidity position with no immediate funding risk, it can also lead to lower income if there are limited opportunities to reinvest the excess funds profitably. Managing these gaps is a central task of the asset-liability management committee within the bank.

- 18.** (C) Settlement occurs on the second working day following the date of the deal.
In the standard terminology of the foreign exchange market, a spot transaction refers to an agreement where the exchange of currencies and the final settlement of funds take place on the second working day after the deal is struck. This conventional timeframe allows banks in different time zones to process the necessary paperwork and complete the physical transfer of funds.
- 19.** (D) Ensuring complete elimination of gap positions in all currencies on a daily basis.
Integrated treasury functions focus on managing liquidity, asset-liability mismatches, and providing benchmark transfer pricing to various business units. While they aim to manage and mitigate risks, it is not always possible or practical to ensure the complete elimination of all gap positions in every currency every day. Instead, they operate within defined risk limits and regulatory requirements to maintain stability.
- 20.** (C) I and III
Foreign exchange arithmetic involves specific rules for rate calculation and value dates. The chain rule is essential for deriving cross rates when a direct quote is unavailable. For telegraphic transfers, the value date is typically the same in both financial centers to ensure simultaneous settlement. However, a per mille represents one part in one thousand, rather than one hundred.
- 21.** (B) II, III, and IV
Futures contracts are standardized financial instruments traded on organized exchanges rather than being tailor-made or traded over-the-counter. Prices and settlement values are determined through transparent electronic platforms or open outcry systems. To ensure market integrity, a clearing house acts as the central counterparty, guaranteeing the performance of both the buyer and the seller for every transaction executed.
- 22.** (C) Both I and II
The value of a currency is significantly influenced by fundamental economic indicators. A surplus in the balance of payments reflects higher demand for the home currency, leading to appreciation. Similarly, robust economic growth often increases production and exports, which further strengthens the currency. These factors combined provide a comprehensive view of a nation's economic standing and its currency's international value.
- 23.** (D) Cross Rate mechanism
When a direct exchange rate between two currencies is not available in the domestic market, dealers must use a cross rate mechanism. This involves using a third currency, typically the US Dollar, which has active trading pairs with both of the target currencies. By combining the rates of these two pairs, the dealer can derive the required exchange rate.
- 24.** (D) Sovereign Risk
Sovereign risk refers to the possibility that a foreign government or a state-owned entity may default on its contractual obligations or claim immunity from legal proceedings. This risk is particularly relevant in international finance, where legal recourse can be complicated by the status of the counterparty. It differs from general credit risk as it involves the legal standing of a nation.
- 25.** (B) Liberalization of exchange control and development of forex markets.
The evolution toward integrated treasury operations was primarily driven by the liberalization of exchange controls and the rapid development of global financial markets. As domestic and foreign exchange markets became more interconnected, banks needed a unified approach to manage liquidity, interest rate risks, and currency exposures. This integration allows for more efficient capital allocation and comprehensive risk management across departments.
- 26.** (D) Brokers acting as principals who assume the ultimate credit risk for every executed trade.
The foreign exchange market comprises various participants with distinct roles. Central banks manage reserves, commercial banks provide liquidity, and corporations engage in trade-related transactions. However, brokers in the forex market function as intermediaries who bring buyers and sellers together. They do not act as principals or assume the credit risk of the trades, which remains with the transacting banks.

- 27. (A)** Deal confirmations from Nostro correspondents are only required annually to minimize operational overhead. Effective risk management in a dealing room requires constant monitoring and prompt reconciliation. Dealers must operate within strictly defined limits, and positions must be verified against overnight open position limits daily. Reconciling Nostro and Vostro accounts frequently is essential for detecting errors. Waiting for annual confirmations would be a major internal control failure, as confirmations must be handled promptly.
- 28. (A)** I and II
Forward margins, including premiums and discounts, reflect the interest rate differentials between two currencies. A currency is at a discount if its forward value is lower than its spot value. In a perfect market, the currency with the higher interest rate will typically trade at a forward discount to the currency with the lower interest rate, preventing simple interest arbitrage.
- 29. (B)** I, III, and IV
Internal control guidelines for dealing rooms emphasize the segregation of duties and rigorous risk quantification. Access rules must be clearly defined for all personnel, and sophisticated models like Value at Risk (VAR) should be used to measure market exposure. Additionally, all trading must stay within established overnight and gap limits to ensure the bank maintains a stable and regulated position.
- 30. (D)** Direct Quote - Also known as Home Currency or Price quotations.
Exchange rate quotations are classified as direct or indirect. A direct quote, also known as a price quotation, expresses the cost of one unit of foreign currency in terms of the variable amount of local currency. In this system, the foreign currency remains fixed. Conversely, an indirect quote expresses a fixed unit of local currency against a variable amount of foreign.
- 31. (C)** Currency Coupon Swaps (CCS)
A currency coupon swap is a sophisticated derivative that allows an entity to hedge multiple risks in a single structure. It typically involves the exchange of both the principal amount and the periodic interest payments between two different currencies. This makes it an ideal tool for managing exposures related to foreign currency loans, covering exchange rate fluctuations and interest rate volatility.
- 32. (B)** 20 days
According to FEDAI guidelines for clean instruments, banks must manage inward remittances efficiently. If a beneficiary fails to provide instructions or respond to a credit in the Nostro account within twenty days, the bank is required to crystallize the remittance. This process involves converting the foreign currency into the local currency at the prevailing rate to settle the transaction.
- 33. (B)** In the Money (ITM)
An option is described as being in the money if exercising it immediately would result in a profit, excluding the initial premium paid. For a call option, this occurs when the current market price is above the strike price. For a put option, it occurs when the market price is below the strike price. This status reflects the option's intrinsic value.
- 34. (C)** Opening Rupee accounts for Exchange Houses to facilitate private remittances without RBI approval.
Authorized Dealer Category I banks have broad authority to handle foreign exchange transactions, but they must still adhere to specific regulatory restrictions. While they can open various accounts and invest in overseas money markets, opening Rupee accounts for non-resident exchange houses typically requires specific approval or adherence to detailed RBI frameworks to ensure the integrity of remittance channels.
- 35. (B)** 9.00 am to 5.00 pm
FEDAI Rule 1 establishes the standard operating hours for the Indian foreign exchange market. For transactions involving foreign currency against the Indian Rupee, the normal market hours are set from 9.00 am to 5.00 pm on all working days. These hours provide a structured timeframe for inter-bank trading and merchant transactions, ensuring consistency and liquidity during the business day.

36. (A) I, II, IV, and V

Regulatory guidelines allow residents and small enterprises to hedge foreign exchange risks using various derivative instruments. Banks can offer forward contracts, interest rate swaps, and cross-currency options to help clients manage exposure. However, it is a critical rule that the maturity of a forward contract must not exceed the tenor of the underlying transaction, ensuring the hedge remains appropriate.

37. (A) Call Option gives the right to purchase the currency; Put Option gives the right to sell the currency.

Foreign exchange options provide the buyer with the right, but not the obligation, to execute a trade at a predetermined rate. A call option grants the holder the right to purchase the underlying currency, which is useful if the price is expected to rise. A put option grants the right to sell the currency, providing protection against a price decline.

38. (D) 2% over the prevailing Savings Bank interest rate.

FEDAI guidelines ensure that customers are compensated for delays in the payment of inward remittances. If a bank fails to pay the customer within the stipulated timeframe after the funds are credited to the Nostro account, it must pay interest for the period of the delay. The prescribed rate for this compensation is two percent above the bank's current savings rate.

39. (B) P-3, Q-1, R-4, S-2

Under FEDAI Rule 8, interest for delayed delivery in inter-bank settlements is calculated using specific benchmark rates for each currency. For the Indian Rupee, the MIBOR is used. For the US Dollar, the base rate of Citi Bank is applied. The Swiss Franc uses the Swiss National Bank's base rate, while the Euro uses the ECB's marginal lending rate.

40. (A) P-2, Q-3, R-1, S-4

The Reserve Bank of India classifies authorized dealers based on the scope of their activities. Category I includes commercial and cooperative banks. Category II covers upgraded money changers and regional rural banks. Category III includes specialized institutions like Exim Bank that handle trade-related transactions.

Full-fledged money changers, including the Department of Posts, are restricted to basic currency exchange for private visits.

41. (B) Realization of Export Bills - Bank sells foreign exchange (Sale transaction)

In foreign exchange accounting, the nature of a transaction is determined by whether the bank is buying or selling foreign currency. When a bank realizes an export bill, it is acquiring foreign currency from the exporter, making it a purchase transaction. Describing it as a sale is incorrect, as sales occur when the bank provides foreign currency for imports or remittances.

42. (C) Executing Principal Only Swaps (POS) to book long-term forward contracts.

Principal Only Swaps are specialized financial derivatives designed to hedge the exchange rate risk associated with the principal amount of a foreign currency loan. By using a POS, a company can lock in the exchange rate for its future principal repayments, effectively converting a foreign currency liability into a fixed local currency obligation and protecting itself from adverse currency movements.

43. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

FEDAI Rule 5 stipulates that for foreign exchange contracts with an option period, the customer always retains the choice regarding the exact date of delivery. Additionally, the rule limits this option period to a maximum of one month. While both statements accurately reflect the regulatory framework for merchant contracts, the time limit itself is not the underlying reason for granting delivery.

44. (B) I, III, IV, and V

Export transactions are governed by specific rules regarding exchange rates and interest. Post-shipment finance uses bill buying rates, and early realizations require interest refunds to exporters. Rules also dictate timely reimbursement claims for bills under letters of credit and specify that dishonored bills must be settled at selling rates. However, transit periods for bills are not uniform across all currencies.

45. (D) USD 1,000,000

To simplify the hedging process for individuals, banks are permitted to allow resident customers to book forward contracts up to a limit of one million US dollars without requiring the production of underlying documents. This facility is intended for transactions on a deliverable basis with tenors up to one year, providing flexibility for managing personal foreign exchange exposures within regulatory bounds.

46. (B) Volatility, defined as the standard deviation of the underlying asset's returns.

The pricing of an option is determined by five key variables: the current spot price, the strike price, the time remaining until expiration, the prevailing interest rate, and the volatility of the underlying asset. Volatility measures the expected magnitude of price fluctuations. These elements combined allow dealers to calculate the fair premium for granting the rights associated with the option contract.

47. (D) I, II, and III

The FX Global Code is a set of principles designed to promote a robust, fair, and liquid foreign exchange market. It aims to establish good practices, engage local market participants, and foster a disciplined environment for dealing room operations. By adhering to these guidelines, institutions contribute to the overall integrity and efficiency of the global wholesale foreign exchange trading landscape.

48. (B) Institutions dealing in forex incidental to international trade financing (e.g., Exim Bank).

Authorized Dealer Category III entities are a specific group of financial institutions authorized by the RBI to undertake foreign exchange transactions that are incidental to their primary business functions. These typically include trade-related institutions like the Exim Bank or SIDBI, which facilitate international trade financing and related activities rather than providing general commercial banking services to the public.

49. (B) Automatic cancellation by the Bank occurs on the fifteenth day from the maturity date.

FEDAI Rule 6 outlines the procedures for the early delivery, extension, or cancellation of forward contracts. If a customer fails to utilize a forward contract by its maturity date, the bank

is required to automatically cancel the contract on the fifteenth day following that maturity. This rule ensures that unutilized positions are cleared from the bank's books in a timely manner.

50. (C) 10 calendar days

Under FEDAI Rule 4, which governs clean instruments, there are strict timelines for the surrender of foreign exchange received through inward remittances. A resident customer who receives such funds must ensure they are surrendered to the bank within ten days. This requirement helps the regulator monitor foreign exchange inflows and ensures that foreign currency is promptly converted or accounted for.

51. (D) Inward remittances are purchase transactions, and outward remittances are sale transactions.

In the context of foreign exchange arithmetic, transactions are always viewed from the perspective of the bank. When a bank receives an inward remittance, it is buying foreign currency from the customer, making it a purchase. Conversely, when a bank processes an outward remittance for a customer, it is selling foreign currency, which is categorized as a sale transaction.

52. (D) Interest Rate Swaps (IRS) where the entity pays fixed and receives floating rates.

To mitigate interest rate risk on a floating-rate loan, a corporate entity can use an Interest Rate Swap. By entering into an agreement to pay a fixed interest rate while receiving a floating rate that matches its loan obligation, the company effectively fixes its interest costs. This removes the uncertainty associated with fluctuations in benchmark rates like SOFR over the loan's tenor.

53. (C) Acting as the central counterparty clearing house for settling all domestic equity derivatives.

FEDAI serves several critical roles in the Indian forex market, including issuing operational guidelines, administering benchmark rates, and accrediting intermediaries like brokers. It also represents India in international forums. However, it does not act as a clearing house for equity derivatives. That function is performed by dedicated clearing corporations like the CCIL for forex and other entities for the equity market.

- 54.** (C) The bank is required to return the funds to the counterparty with interest. FEDAI Rule 8 addresses the principle of undue enrichment, which occurs when a bank receives funds or benefits to which it is not entitled due to an error or delay in settlement. In such cases, the bank is strictly prohibited from retaining the excess funds. It must return the enriched amount to the affected counterparty, along with interest at the prescribed benchmark rate.
- 55.** (A) Rs. 1,000 per day, capped at Rs. 10,000 per instance. FEDAI Rule 4 mandates timely documentation for transfers between banks. When a bank transfers funds from a Vostro account to another institution, it must submit Form A3 within five working days. Failure to meet this deadline results in a penalty of one thousand rupees for every day of the delay, with the total penalty for a single instance capped at ten thousand.
- 56.** (B) II, III, and B
Currency swaps and zero-coupon swaps are versatile financial tools. A currency swap allows for the exchange of cash flows in different currencies, facilitating the hedging of both exchange and interest rate risks. Zero-coupon swaps can be structured to consolidate all fixed-rate payments into a single final payment. However, unlike currency swaps, standard interest rate swaps do not involve an exchange of principal.
- 57.** (A) Only I
Regulatory limits are placed on banks' overseas borrowings to maintain financial stability. Borrowings, including temporary overdrafts in Nostro accounts lasting more than five days, are generally capped at one hundred percent of Tier 1 capital or ten million dollars. However, borrowings specifically intended for extending export credit in foreign currency are excluded from this ceiling, allowing banks more flexibility in supporting international trade.
- 58.** (A) A Self-Regulatory Organization formed in 1958 to regulate the dealings of Authorized Dealers.
FEDAI is a self-regulatory organization established in 1958 with the approval of the Reserve Bank of India. Its primary purpose is

to formulate rules and guidelines that govern the day-to-day foreign exchange business of its member banks, who are authorized dealers. It ensures uniformity in market practices, provides a platform for industry representation, and helps maintain a disciplined trading environment.

- 59.** (A) I, II, and III
FEDAI Rule 7 governs the use of intermediaries in the foreign exchange market. These include traditional brokers and modern electronic platforms. All intermediaries must be accredited by FEDAI, and electronic systems like multi-bank portals also require specific RBI authorization. Furthermore, all resulting contracts must explicitly state they are subject to FEDAI rules to ensure compliance with standardized Indian market practices and regulations.
- 60.** (B) The crystallization of Import bills is executed applying the TT buying rate.
Import transactions involve the bank selling foreign exchange to the customer. When retiring an import bill, the bank applies the bill selling rate. If an import bill remains unpaid, the crystallization process involves converting the liability into local currency. This must be done using the bank's selling rate, not the buying rate, as the bank is still effectively disposing of foreign currency.
- 61.** (C) 75.0270
To calculate the merchant spot rate for a purchase transaction, the bank must deduct the exchange margin from the inter-bank spot buying rate. In this scenario, applying a 0.15% margin to the spot rate of 75.14 results in a deduction of approximately 0.1130. Subtracting this from the original rate yields 75.0270, which serves as the base before adding any forward premiums.
- 62.** (A) The need to bypass the Bank's Net Overnight Open Position Limit.
Swaps are used by institutions to manage cash flows, hedge against interest rate fluctuations, or take advantage of better financial terms. They are legitimate tools for risk management and investment strategy. However, using swaps for the purpose of bypassing regulatory limits, such as the Net Overnight Open Position Limit, is not a valid or permissible reason for entering into these contracts.

63. (C) I, II, and IV

Inward remittances represent foreign currency entering the country and being converted into local currency. This includes proceeds from exports, foreign contributions received under FCRA, and foreign direct investment into Indian companies. Conversely, payments made by resident individuals to overseas family members are classified as outward remittances, as they involve the conversion of local currency into foreign exchange for payment abroad.

64. (A) A forward purchase contract must be cancelled at the opposite TT selling rate.

When a customer requests the cancellation of a forward purchase contract, the bank must effectively reverse the original transaction. Since the original contract was a purchase of foreign exchange by the bank, the cancellation is treated as a sale of that currency back to the customer. Therefore, the bank applies the prevailing telegraphic transfer selling rate to execute the cancellation process.

65. (C) Foreign exchange received by TT in the Nostro account – Bank applies TT Buying rate.

The exchange rate applied to an inward remittance depends on the instrument used. For funds received via telegraphic transfer that are credited to the bank's Nostro account, the bank applies the TT buying rate. This rate is used because the funds are already available in the bank's account abroad, and there is no need for a transit period or physical handling of documents.

66. (A) I and II

FEDAI plays a vital role in representing the Indian banking industry's interests in international trade forums and participating in the revision of global rules like the UCP. It also provides essential administrative services, such as calculating month-end revaluation rates for its members. However, it does not have the authority to set the Cash Reserve Ratio, which is a monetary policy tool.

67. (A) I, II, III, and V

Calculating the forward rate for an export bill involves a specific sequence of steps. The dealer starts with the inter-bank spot buying rate, adds the appropriate forward premium, and then deducts the exchange margin. Additionally, the

bank must pass on any premium accrued for the period before the start of the delivery option to the customer, ensuring a fair and transparent calculation.

68. (B) 74.9050

For an inward remittance, the bank acts as a buyer of foreign currency and applies its bid rate. Starting with the inter-bank bid rate of 75.0050, the bank subtracts its internal margin of 0.1000 (10 paise). This results in a final rate of 74.9050 for the customer. In purchase transactions, the margin is always deducted to arrive at the final merchant rate.

69. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

In the Indian market, the US Dollar is the most actively traded currency against the Rupee, providing highly liquid direct rates. For other currencies like the British Pound, direct quotes are less common. Therefore, dealers rely on the cross-rate mechanism, using the USD/INR and GBP/USD pairs to derive the GBP/INR rate. This standard practice ensures accuracy based on active market prices.

70. (A) P-3, Q-4, R-1, S-2

FEDAI rules are organized numerically by subject to provide clear operational guidance for authorized dealers. Rule 2 governs export transactions, while Rule 3 covers import procedures. Rule 4 is dedicated to the handling of clean instruments and inward remittances. Rule 5 provides the framework for foreign exchange contracts, including definitions for delivery periods and the rounding of exchange rate quotes.

71. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

When a bank processes an outward remittance for a customer to pay an overseas supplier, it is performing a sale transaction. The bank sells the required foreign currency to the customer in exchange for local rupees. Because the funds are usually transferred electronically via the bank's Nostro account, the bank applies the telegraphic transfer selling rate, which is the standard rate for such transactions.

72. (D) Buy GBP against USD and buy USD against INR, then add the required margin.

When a customer retires an import bill in a currency like GBP, the bank must provide that currency. Using cross rates, the bank must effectively purchase GBP using USD in the international market and purchase those USD using INR. To ensure profitability and cover costs, the bank uses the offer rates for both pairs and adds the necessary exchange margin to the final.

73. (B) I, III, IV, and V

Derivatives are essential tools for managing future receivables and payables through hedging. Forward contracts and various types of swaps, such as basis swaps, allow for the customized exchange of cash flows. In option contracts, the parties are clearly defined as the holder and the writer. However, unlike forwards, futures are standardized contracts that must be traded on organized, regulated financial exchanges.

74. (B) I, III, and IV

Swaps are flexible, over-the-counter agreements that allow two parties to exchange cash flows over a specified period. They are not traded on organized futures exchanges, which allows for greater customization of terms. In a standard interest rate swap, the parties exchange interest payments based on a notional amount without ever exchanging the actual principal, making it an efficient tool for managing interest exposure.

75. (A) 75.1075

In an outward remittance transaction, the bank acts as a seller of foreign exchange and applies its offer rate. Starting with the inter-bank offer rate of 75.0075, the bank adds its exchange margin of 0.1000 (10 paise). This results in a final merchant rate of 75.1075. In sale transactions, the margin is always added to the inter-bank rate to cover costs.

76. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

For forward sale contracts where the customer has an option period for delivery, the bank must protect itself against potential market movements. Since the customer might choose to take delivery on the very last day of the contract, the bank charges the premium for the entire

period up to that end date. This ensures the bank is compensated for the longest possible exposure.

NODIA

77. (C) The Bank applies the Currency Notes selling rate.

When a bank sells physical foreign currency notes to a customer, it applies a specific currency notes selling rate. This rate is different from the telegraphic transfer or bill selling rates because it accounts for the additional costs associated with handling, storing, and transporting physical cash. These overheads are reflected in the margin included within the specific rate quoted for currency notes.

78. (A) I and II

Outward remittances involve the conversion of local currency into foreign exchange for payment abroad. Permissible examples include the repatriation of funds from non-resident external accounts and the settlement of import bills for goods received. However, advance payments received for exports are inward remittances, as they represent foreign currency entering the country to be converted into rupees for the local exporter's use.

79. (C) Both I and II

In forward contract pricing, the treatment of premiums depends on the transaction type. For a merchant sale, the premium is added to the inter-bank selling rate. For a forward purchase, the bank only passes on the premium to the customer up to the beginning of the option period. These rules ensure that the bank is adequately compensated for the risks it assumes.

80. (A) All merchant transaction rates are strictly rounded to the nearest 10 paise.

FEDAI Rule 5 provides specific guidelines for foreign exchange contracts to maintain market uniformity. These rules mandate that contracts must have definite amounts and delivery periods. While the rule specifies procedures for holidays and delivery options, it requires that merchant exchange rates be rounded to the nearest 0.0025 according to standard practice, not specifically to ten paise as incorrectly suggested in this instance.

CHAPTER 02

Liberalised Remittance Scheme and Other Remittance Facilities for Residents

Oct/Nov 2018

1. A resident individual transfers USD 50,000 into a newly opened non-interest-bearing Foreign Currency Account (FCA) in an International Financial Services Centre (IFSC) in India to explore overseas securities.

He finds no suitable investment and leaves the funds idle in the FCA for 20 days.

What regulatory action is triggered by this delay?

- (A) The funds are automatically converted into fixed deposits bearing standard domestic interest rates after the fifth day of inactivity.
- (B) Any funds lying idle in the account for up to 15 days from credit must be repatriated to the domestic INR account.
- (C) The investor faces an immediate penalty of thrice the idle amount for contravention of the International Financial Services Centre rules.
- (D) The Authorized Dealer Bank must permanently block the FCA and report the individual to the enforcement authorities for non-compliance.

May/June 2012

2. Which of the following pairs concerning documentation for remittances is incorrectly matched?
- (A) Simplified documentation for individuals — Available for amounts up to USD 25,000.
 - (B) Form A2 — Online submission is permitted.
 - (C) Permanent Account Number (PAN) — Mandatory only for remittances above USD 250,000.
 - (D) Form ODI Part I — To be submitted within 30 days of making the first remittance.

Oct/Nov 2025

3. Which of the following represents a current account transaction?
- (A) A parent remitting funds to a dependent child abroad towards education expenses

and maintenance.

- (B) Investing abroad in the equity of an overseas company resulting in the creation of an asset.
- (C) Purchasing immovable property situated outside India by a resident individual.
- (D) Acquiring and holding shares of a foreign company towards professional services rendered.

May/June 2007

4. Consider the following statements regarding disinvestments in Overseas Direct Investments by resident individuals:

- I. Disinvestments are allowed only after one year from the date of making the first investment.
- II. Resident individuals are permitted to write-off capital losses incurred during disinvestments.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2014

5. How is a “relative” defined for the purpose of determining permissible transactions under foreign exchange regulations?
- (A) Individuals are relatives only if they belong to the same Hindu Undivided Family and share ancestral property.
 - (B) Any individual sharing the same permanent residential address and possessing joint financial assets or accounts.
 - (C) Two individuals engaged in a formal partnership firm recognized under the Indian Partnership Act or a corporation.
 - (D) Members of an HUF, spouses, or those related as father, mother, son, or daughter in a specifically prescribed manner.

May/June 2019

6. Consider the following statements regarding students going abroad for studies:
- I. Students going abroad for studies are treated as Non-Resident Indians (NRIs) under foreign exchange regulations.
 - II. They can remit up to USD 1 Million from their NRO accounts per financial year provided the credits are legitimate dues in India.
- Which of the above statement(s) is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2006

7. What is the maximum penalty for a quantifiable contravention of the Foreign Exchange Management Act?
- (A) Up to twice the amount involved in the contravention.
 - (B) Up to thrice the amount involved in the contravention.
 - (C) A fixed penalty of Rs. 2,00,000 irrespective of the amount involved.
 - (D) A maximum penalty of Rs. 10,000 with an additional Rs. 2,000 for every continuing day.

May/June 2021

8. Consider the following statements relating to loans provided by resident individuals to NRI close relatives:
- I. The loan amount can be freely remitted outside India to support the NRI's foreign business.
 - II. The loan must be free of interest and possess a minimum maturity of one year.
 - III. Proceeds of the loan may be credited to the NRO account of the NRI.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2010

9. Up to what monetary limit may travelers proceeding to Iraq and Libya be released foreign exchange in the form of foreign currency notes?
- (A) USD 3,000

- (B) USD 5,000
- (C) USD 25,000
- (D) Full exchange without any upper limit

May/June 2005

10. Consider the following statements regarding emigration remittances:
- I. Foreign exchange beyond USD 250,000 may be released if strictly required by the country of emigration for incidental expenses.
 - II. The extra release of foreign exchange can be utilized to earn points for immigration by investing in foreign Government Bonds.
 - III. Documentary evidence must be submitted by the individual to the satisfaction of the Authorized Dealer Bank.
- Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2022

11. Which of the following mandates the correct handling of acquired foreign exchange?
- (A) Foreign exchange must be used for the permissible purpose or surrendered within a specified period if unused.
 - (B) The Reserve Bank of India maintains the power to penalize Authorized Persons in case of any procedural breach.
 - (C) Certain capital account transactions are completely prohibited for resident individuals under federal guidelines.
 - (D) Daily transaction-wise reporting is required on a specialized digital platform maintained by the regulator.

May/June 2018

12. Consider the following statements concerning Overseas Direct Investments (ODI) by resident individuals:
- I. Investments can be made in both listed and unlisted overseas companies.
 - II. A resident individual is permitted to make direct investments in FATF Non-compliant countries with prior regulatory approval.
 - III. The overseas Joint Venture must be an operating entity, and no step-down subsidiary is allowed to be acquired.
 - IV. Share certificates or other documentary evidence must be submitted within 6 months

from the date of making the remittance.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2016

13. What is the residential status and corresponding account requirement for students going abroad for studies under foreign exchange regulations?
- (A) They are considered resident individuals and must maintain their existing domestic savings accounts.
 - (B) They are considered NRIs, and their existing resident account needs to be designated as an NRO account.
 - (C) They are considered foreign citizens and must open an Exchange Earners Foreign Currency (EEFC) account.
 - (D) They are considered temporary migrants and must close all Indian banking accounts before departure.

May/June 2014

14. Consider the following statements regarding the general operational guidelines of the Liberalised Remittance Scheme:
- I. PAN is mandatory irrespective of the amount of the remittance.
 - II. Once the USD 250,000 limit is utilized, further remittances are allowed if proceeds of previous investments are brought back into the country.
 - III. Citizens of a foreign state resident in India on employment for less than 3 years are eligible to make remittances under LRS.
 - IV. Any amount requested in excess of the LRS limits requires prior approval from the Reserve Bank of India.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2007

15. Which of the following statements correctly reflects the regulations regarding foreign bank guarantees?
- (A) Foreign bank guarantees are freely permitted towards educational purposes in

favor of overseas universities.

- (B) Foreign bank guarantees can be issued to facilitate direct investments in FATF non-compliant countries.
- (C) Foreign bank guarantees are permitted to earn credits for immigration by way of overseas investments.
- (D) Foreign bank guarantees towards overseas employers or immigration are strictly not permitted.

May/June 2025

16. Consider the following statements regarding the penalties for contravention of foreign exchange regulations:
- I. The penalty can extend up to thrice the amount involved if the contravention is quantifiable.
 - II. The penalty is capped at Rs. 2,00,000 where the contravention amount is not quantifiable.
 - III. In the case of a continuing contravention, an additional penalty of Rs. 10,000 per day is levied.
 - IV. The penalty for continuing contraventions applies for every day after the first day during the period of contravention.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, II, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2019

17. Which of the following statements correctly describes the rules for business trips where expenses are borne by the employing company?
- (A) Such business trips consume the employee's individual USD 250,000 limit under the Liberalised Remittance Scheme.
 - (B) These expenses fall outside the purview of the Liberalised Remittance Scheme and may be permitted without any limit.
 - (C) The employee must obtain prior approval from the Ministry of Finance before undertaking the trip.
 - (D) The remittance for such trips is strictly prohibited if it involves specialized training abroad.

NODIA

May/June 2009

18. Consider the following relationships and identify which combination represents individuals correctly classified as a “relative” for gifting under the Liberalised Remittance Scheme guidelines:

- I. Father (including step father)
- II. Brother’s wife
- III. Son (including step son)
- IV. Sister (including step sister)
- V. Daughter’s son

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) III, IV, and V only
- (D) I, II, IV, and V only

Oct/Nov 2011

19. Which of the following statements regarding Tax Collected at Source (TCS) provisions is incorrect?

- (A) TCS is applicable to all remittances by non-individuals and for payment of import of goods and services.
- (B) The threshold for TCS is Rs 7 lakhs for an entire financial year.
- (C) In the case of non-availability of PAN or Aadhar, the TCS rate is elevated to 10%.
- (D) Remittances under LRS for studies abroad sourced from an educational loan attract a TCS of 0.5% over the threshold limit.

May/June 2010

20. Consider the following statements pertaining to specific current account remittances:

- I. Cash towards release of exchange for private visits can be accepted up to Rs. 50,000 irrespective of the number of visits.
- II. Travelers proceeding to the Russian Federation can receive full exchange in the form of foreign currency notes.
- III. Emigration remittances beyond USD 250,000 are permitted if required by the country of immigration for incidental expenses.
- IV. Expenses in connection with medical treatment abroad strictly require a doctor’s estimate for any amount below USD 250,000.
- V. Studies abroad remittances can exceed USD 250,000 based on documentary evidence from the overseas university.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2024

21. Which of the following statements concerning remittances to International Financial Services Centres (IFSCs) is incorrect?

- (A) Remittances shall be made only for making investments in securities other than those issued by entities resident in India.
- (B) Resident individuals are permitted to open a non-interest-bearing Foreign Currency Account in IFSCs.
- (C) Any funds lying idle in the account for up to 15 days from the date of credit must be repatriated to a domestic INR account.
- (D) Domestic transactions are freely permissible to be settled with other residents through Foreign Currency Accounts held in IFSCs.

May/June 2017

22. The following question consists of two statements – Assertion (A) and Reason (R). Answer this question selecting the appropriate option given below:

Assertion (A): A resident individual minor is permitted to avail foreign exchange up to a maximum of USD 250,000 in a financial year under the LRS.

Reason (R): The Liberalised Remittance Scheme is explicitly available to all resident individuals, including minors, provided KYC and source of funds guidelines are complied with.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

23. All of the following entities or individuals are excluded from availing the benefits of the Liberalised Remittance Scheme EXCEPT:

- (A) Partnership Firms
- (B) Resident Individuals including Minors
- (C) Hindu Undivided Families (HUFs)

(D) Charitable Trusts

May/June 2020

24. The following question consists of two statements – Assertion (A) and Reason (R). Answer this question selecting the appropriate option given below:
 Assertion (A): Students proceeding abroad for higher education are designated as Non-Resident Indians (NRIs) under the Foreign Exchange Management Act.
 Reason (R): NRIs are authorized to remit up to USD 1 Million per financial year from their NRO accounts, provided the credits are legitimate dues in India.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2015

25. A resident individual is prohibited from making direct investments in an overseas Joint Venture or Wholly Owned Subsidiary engaged in all of the following activities EXCEPT:
- (A) Bonafide manufacturing activities
 (B) Real estate business
 (C) Banking business
 (D) The business of financial service activities

May/June 2013

26. The following question consists of two statements – Assertion (A) and Reason (R). Answer this question selecting the appropriate option given below:
 Assertion (A): A resident individual is prohibited from making a direct investment in an overseas Joint Venture that is engaged in the real estate business.
 Reason (R): Overseas Direct Investments are strictly restricted to equity shares of listed companies only.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2021

27. When an applicant seeking remittances under the LRS is a completely new customer to the Authorized Dealer Bank, what is the most appropriate initial action required by the AD?
- (A) Carry out thorough due diligence regarding the opening and maintenance of the account.
 (B) Instantly process the remittance to comply with liberalization policies.
 (C) Automatically deduct a 10% TCS to secure the transaction risk.
 (D) Request an immediate approval from the regulatory authority before proceeding.

May/June 2024

28. Ms. Gupta made a remittance of Rs 6,50,000 on April 10, 2020, under the LRS. *She subsequently makes another remittance of Rs 5,00,000 on June 15, 2020, for an international leisure trip.*
 Assuming she has submitted her PAN, what will be the Tax Collected at Source (TCS) calculated on her second remittance?
- (A) No tax will be collected as each individual transaction is below Rs 7,00,000.
 (B) 5% tax will be collected on Rs 4,50,000.
 (C) 5% tax will be collected on the entire Rs 5,00,000.
 (D) 10% tax will be collected on Rs 4,50,000 due to aggregated threshold crossing.

Oct/Nov 2008

29. Which of the following provides the most appropriate condition for releasing foreign exchange exceeding USD 250,000 for medical treatment abroad?
- (A) The remittance is automatically permitted if the patient is accompanied by a registered medical attendant.
 (B) Authorized Dealers may release exchange based on formal estimates from a doctor in India or the hospital abroad.
 (C) The individual must secure special permission from the Ministry of Health and Family Welfare for any amount in excess.
 (D) The extra amount must be drawn exclusively from an existing EEFC or RFC account maintained with an Authorized Dealer.

May/June 2006

30. A husband and wife, both resident individuals in India, wish to jointly purchase a property in London.

They plan to consolidate their individual LRS limits for this specific capital account transaction.

Which of the following conditions must they fulfill to successfully complete this transaction?

- (A) Only the husband's primary account can be debited for the total consolidated amount of USD 500,000 for administrative simplicity.
- (B) The overseas property must be registered exclusively in the name of a Joint Venture company formed for the acquisition.
- (C) They must comply with terms individually and both must be registered co-owners of the overseas property.
- (D) They must secure a formal credit facility from the AD Bank to facilitate and guarantee this joint capital account transaction.

Oct/Nov 2017

31. What is the most appropriate regulatory action for funds lying idle in a Foreign Currency Account established by a resident individual in an International Financial Services Centre (IFSC)?

- (A) The funds can be retained indefinitely in the offshore account as long as no domestic transactions are settled.
- (B) The funds must be invested in an overseas real estate business or a foreign equity instrument to remain compliant.
- (C) The idle funds are automatically converted into government-backed bonds after a period of 30 days of inactivity.
- (D) Any funds lying idle in the account for up to 15 days from credit must be repatriated to the investor's domestic INR account.

May/June 2008

32. An Indian resident trader wishes to remit USD 100,000 to an overseas exchange to meet a sudden margin call on his international commodity trades. He submits the request to his Authorized Dealer (AD) Bank along with his PAN and Aadhar. What action should the AD Bank take?

- (A) Process the remittance immediately as it is well within the USD 250,000 limit and all documentation is provided.
- (B) Deduct 5% TCS on the equivalent INR

amount above Rs 7 lakhs and process the transfer to the overseas exchange.

- (C) Hold the funds in an idle Foreign Currency Account for 15 days before remitting them to the international exchange.
- (D) Reject the request as payments for margin calls to overseas exchanges are explicitly prohibited.

Oct/Nov 2013

33. Determine the correct chronological sequence of post-investment compliance steps for a resident individual making an Overseas Direct Investment:

- 1. Submission of Annual Performance Reports (APRs).
- 2. Repatriation of disinvested proceeds to India.
- 3. Submission of Part I of Form ODI.
- 4. Submission of share certificates or documentary evidence.

(A) 3, 4, 1, 2

(B) 4, 3, 2, 1

(C) 3, 1, 4, 2

(D) 1, 3, 4, 2

May/June 2015

34. Deepak, an Indian student studying in Australia, is now recognized as an NRI under foreign exchange regulations. His parents deposited legitimate Indian rental income into his newly designated NRO account. Deepak wishes to remit USD 1.2 Million from his NRO account to his Australian bank account for a property purchase. What is the regulatory restriction on this transaction?

- (A) The transaction is completely allowed since the funds originated from legitimate dues in India and the bank has verified the income.
- (B) Deepak can only remit up to USD 250,000 as per the standard LRS limits applicable to individuals regardless of their status.
- (C) Deepak can remit up to USD 1 Million per year; the excess amount requires specific regulatory approval.
- (D) Students are barred from purchasing property abroad while on a student visa, making the entire proposed transaction invalid.

Oct/Nov 2012

35. Match the key sections of foreign exchange regulations with their corresponding subject matter.

List I: Regulatory Section

- P. Restriction on holding foreign exchange
Q. Capital account transactions
R. Power of RBI to issue directions
S. Penalties for contravention

List II: Subject Matter

1. RBI's power to issue directions and penalize APs for procedural breach.
2. Penalties imposed for contraventions of regulatory provisions.
3. General restriction on acquiring, holding, or transferring foreign exchange/property abroad.
4. Permissibility and limits of capital account transactions.

- (A) P-3, Q-4, R-1, S-2
(B) P-4, Q-3, R-2, S-1
(C) P-3, Q-1, R-4, S-2
(D) P-1, Q-2, R-3, S-4

May/June 2011

36. Mr. Singh wants to lend USD 50,000 in equivalent INR to his NRI brother to help him expand his manufacturing business in the UK. Mr. Singh proposes a 5% annual interest rate on the loan with a repayment maturity of 2 years. Why will the Authorized Dealer (AD) Bank reject this loan agreement under LRS provisions?

- (A) Loans to NRI relatives cannot exceed a maximum maturity of one year from the date of the first disbursement.
(B) Business purposes are strictly excluded from permissible loan utilizations for NRIs under the current Liberalised Remittance Scheme.
(C) Repayment of such loans must be made exclusively in foreign currency notes or through an NRE account of the borrower.
(D) Loans provided by resident individuals to NRI close relatives must be interest-free.

Oct/Nov 2020

37. Match the Tax Collected at Source (TCS) scenarios with their corresponding applicable tax treatments.

List I: TCS Scenarios

- P. Total remittance of Rs 6,50,000 in a financial year
Q. Remittance of Rs 9,00,000 with available

PAN

- R. Remittance of Rs 10,00,000 obtained through an educational loan
S. Remittance exceeding Rs 7,00,000 without available PAN/Aadhar

List II: Tax Treatment

1. 0.5% tax collected on the amount exceeding the threshold
2. 10% tax collected on the amount exceeding the threshold
3. No tax will be collected
4. 5% tax collected on the amount exceeding the threshold

- (A) P-3, Q-4, R-1, S-2
(B) P-4, Q-3, R-2, S-1
(C) P-3, Q-1, R-4, S-2
(D) P-1, Q-2, R-3, S-4

May/June 2022

38. Mr. Verma returned from a private visit to Europe with USD 4,000 in unutilized foreign currency notes. According to the regulatory framework, what is the mandated protocol for this unutilized foreign exchange?

- (A) He must deposit it into his domestic savings account within 30 days of his return from the international private visit.
(B) He can retain the foreign currency notes indefinitely in his possession for use during his next scheduled international trip.
(C) He is required to surrender the unutilized foreign exchange to the AD within 180 days from his return to India.
(D) He must convert the foreign currency into government-issued bonds within 90 days of returning to the home country.

Oct/Nov 2023

39. Which of the following pairs correctly matches the type of transaction with its regulatory classification?

- (A) Remittance for purchase of lottery tickets — Permissible current account transaction.
(B) Going abroad for employment — Permissible remittance under delegated powers of Authorized Dealers.
(C) Payment of imports through Ocean Transport on CIF basis by PSUs — Non-permissible remittance.
(D) Payment related to "Call Back Services" of telephones — Remittance permissible subject to Government approval.

NODIA

May/June 2016

40. A State Government Public Sector Undertaking (PSU) wishes to release an extensive advertisement campaign in a foreign print media publication to attract foreign direct investment. Under current guidelines, whose approval is mandatory before this remittance can be executed?
- (A) Ministry of Finance
(B) Ministry of Information & Broadcasting
(C) Ministry of Human Resources Development
(D) Ministry of Surface Transport

Oct/Nov 2009

41. Based on the definition of a “relative” for gifting purposes under the Liberalised Remittance Scheme, which pair is incorrectly matched regarding its inclusion status?
- (A) Sister’s husband — Included as a relative
(B) Step father — Included as a relative
(C) Mother’s father — Excluded from being a relative
(D) Daughter’s husband — Included as a relative

May/June 2023

42. Which of the following best defines a capital account transaction?
- (A) A transaction which includes payments connected to trade, interest on loans, and net income on overseas investments.
(B) A transaction altering assets or liabilities, including contingent liabilities, outside India of persons resident in India.
(C) A transaction involving only the remittance of funds for family maintenance and medical treatment of relatives abroad.
(D) A transaction specifically restricted to the purchase of foreign currency notes for private visits or business trips.

Oct/Nov 2018

43. Consider the following statements regarding the issuance of Foreign Bank Guarantees under the Liberalised Remittance Scheme:
- I. Foreign Bank guarantees towards educational purposes in favor of Overseas Universities are permitted.
II. Foreign Bank guarantees towards Overseas employers or Immigration are not permitted.
- Which of the above statement(s) is/are correct?
- (A) Only I
(B) Only II

- (C) Both I and II
(D) Neither I nor II

May/June 2012

44. What constitutes a Direct Investment outside India for a resident individual?
- (A) Making portfolio investments in foreign stock exchanges to generate short-term trading profits.
(B) Extending an interest-bearing loan to an NRI close relative for acquiring real estate abroad.
(C) Investment via contribution to capital or subscription to the Memorandum of Association of a foreign entity.
(D) Opening a non-interest-bearing Foreign Currency Account in an International Financial Services Centre.

Oct/Nov 2025

45. Consider the following statements regarding the consolidation of remittances under LRS for capital account transactions:
- I. Remittances can be consolidated in respect of family members provided all the family members are co-owners of the Overseas Property.
II. Credit facilities can be freely extended by Authorized Dealers to facilitate such consolidated capital account transactions.
- Which of the above statement(s) is/are correct?
- (A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

May/June 2007

46. On which date was the Liberalised Remittance Scheme (LRS) for Resident Individuals introduced?
- (A) 4th February 1999
(B) 1st July 2005
(C) 4th February 2004
(D) 1st October 2020

Oct/Nov 2014

47. Consider the following statements regarding Tax Collected at Source (TCS) on foreign remittances:
- I. The threshold for TCS application is Rs 7 lakhs for an entire financial year.
II. TCS is applicable to remittances made by non-individuals and for payment of import of goods or services.

III. If the source of funds for studies abroad is an educational loan, TCS is collected at 0.5% over the threshold limit.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2019

48. What is the stipulated time frame for a resident individual to surrender unutilized foreign exchange to an Authorized Dealer from the date of return to India?
- (A) Within 30 days
 - (B) Within 60 days
 - (C) Within 90 days
 - (D) Within 180 days

Oct/Nov 2006

49. Consider the following statements about the reporting requirements under the Liberalised Remittance Scheme:
- I. Authorized Dealers must upload daily transaction-wise information on a digital platform.
 - II. Reporting must be completed by the close of business of the next working day.
 - III. If there are no transactions on a particular business day, the Authorized Dealer is exempt from filing any report.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) I and III only
 - (C) II and III only
 - (D) I, II, and III

May/June 2021

50. Which of the following entities is eligible to avail of the foreign exchange facilities under the Liberalised Remittance Scheme?
- (A) Registered Partnership Firms
 - (B) Incorporated Corporate Bodies
 - (C) Resident Individuals including Minors
 - (D) Non-Resident Indians (NRIs)

Oct/Nov 2010

51. Consider the following statements regarding the purchase of Objects of Art:
- I. Remittances for purchasing Objects of Art are strictly prohibited under the Liberalised Remittance Scheme.

II. Resident individuals can import objects of art for personal purposes not connected with trade or commercial purpose.

III. The purchase of Objects of Art is subject to the conditions laid out in the Foreign Trade Policy.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2005

52. If a sole proprietorship firm intends to remit money under the Liberalised Remittance Scheme by debiting its current account, how is the eligibility determined?
- (A) The firm is treated as a corporate entity and is entirely ineligible for the remittance.
 - (B) The eligibility is calculated based on the firm's annual turnover during the preceding financial year.
 - (C) The firm requires prior approval from the Reserve Bank of India regardless of the remittance amount.
 - (D) The eligibility of the proprietor in his individual capacity is reckoned to allow the remittance.

Oct/Nov 2022

53. Consider the following statements regarding remittances to International Financial Services Centres (IFSCs):
- I. Remittances are permitted for making investments in securities issued by entities resident in India outside the IFSC.
 - II. Investors can open a non-interest-bearing Foreign Currency Account (FCA) in IFSCs.
 - III. Any funds lying idle in the FCA for up to 15 days must be immediately repatriated to the domestic INR account.
 - IV. Domestic transactions are not permissible to be settled with other residents through these FCAs.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

NODIA

May/June 2018

54. Which of the following statements is correct regarding the operational guidelines of the Liberalised Remittance Scheme?
- (A) International Credit Cards and International Debit Cards cannot be used for current account transactions.
 - (B) Permanent Account Number (PAN) is mandatory only for remittances exceeding USD 25,000.
 - (C) There are no restrictions on the frequency of remittances within a financial year as long as the total does not exceed USD 250,000.
 - (D) Once a remittance of USD 250,000 is utilized, further remittances are allowed if investment proceeds are brought back into the country.

Oct/Nov 2016

55. Consider the following statements detailing non-permissible remittances:
- I. Remittances for margins or margin calls to overseas exchanges are not permitted.
 - II. Payment related to "Call Back Services" of telephones is strictly prohibited.
 - III. Remittance of dividend by any company subject to dividend balancing is not permitted.
 - IV. Payment of commission on exports made towards equity investments in WOS abroad is fully allowed.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, III, and IV only
 - (C) II, III, and IV only
 - (D) I, II, III, and IV

May/June 2014

56. Which of the following statements is correct concerning disinvestments made by resident individuals under the Overseas Direct Investment route?
- (A) Disinvestments must be repatriated to India no later than 60 days from the date of disinvestment.
 - (B) Disinvestments are allowed immediately after the initial investment is completed.
 - (C) Resident individuals are allowed to write-off capital losses incurred during disinvestments.
 - (D) Post-investment alterations do not require reporting to the Designated Authorized

Dealer.

Oct/Nov 2007

57. Consider the following statements concerning documentation requirements for handling Liberalised Remittance Scheme requests:
- I. Form A2 online submission is allowed in lieu of physical declarations.
 - II. Simplified documentation is acceptable for individuals for amounts up to USD 25,000 subject to Authorized Dealer bank satisfaction.
 - III. A declaration of the source of funds is a mandatory requirement.
 - IV. The tour operator can collect amounts from the resident individual exclusively in INR and cannot open a special foreign currency account.
 - V. Tax Collected at Source (TCS) is applicable in respect of release of exchange by tour operators irrespective of threshold limits.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V only
 - (B) I, II, IV, and V only
 - (C) II, III, IV, and V only
 - (D) I, II, III, IV, and V

May/June 2025

58. Which of the following statements regarding prohibited remittances is incorrect?
- (A) Remittances for margins or margin calls to overseas exchanges are not permitted.
 - (B) Payment of commission on exports made towards equity investments in Joint Ventures abroad is freely permitted.
 - (C) Remittance of dividend by any company to which the requirement of dividend balancing is applicable is prohibited.
 - (D) Remittances out of lottery winnings and income from racing or riding are strictly prohibited.

Oct/Nov 2019

59. Consider the following statements regarding capital account transactions permitted under the Liberalised Remittance Scheme:
- I. Resident individuals can purchase immovable property abroad.
 - II. Direct investments can be made in overseas companies engaged in the real estate business.
 - III. Resident individuals can extend loans in

INR to NRIs who are close relatives.

- IV. Foreign currency accounts can be opened abroad for facilitating investment transactions.
- V. Qualification shares of an overseas company can be acquired for holding the post of a Director.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, III, IV, and V

May/June 2009

60. Which of the following statements regarding reporting requirements is incorrect?
- (A) Authorized Dealers are required to upload daily transaction-wise information undertaken by them.
 - (B) The reporting of daily transactions is conducted on a digital platform by the close of business of the next working day.
 - (C) A NIL report is not required to be uploaded even if there are no transactions on a particular business day.
 - (D) The data on daily reporting is systematically made available to all the Authorized Dealer Banks.

Oct/Nov 2011

61. Consider the following statements regarding the source of funds and due diligence by an Authorized Dealer (AD):
- I. The AD must examine the statement of account to check previous credits against transaction summaries.
 - II. Suspicious Transaction Reports (STRs) filed in respect of the account must be scrutinized.
 - III. If bank statements are unavailable, a copy of the Income Tax assessment or return is completely unacceptable.
 - IV. The AD ensures ease of transactions by framing appropriate guidelines for Customer Interface.
 - V. Resident individuals on the regulatory caution list or defaulters list are permitted to make Overseas Direct Investments under strict AD supervision.

Which of the above statement(s) is/are correct?

- (A) I, II, and IV only
- (B) I, II, III, and IV only

- (C) II, III, and V only
- (D) I, II, IV, and V only

May/June 2010

62. Under the Liberalised Remittance Scheme, all of the following remittances are explicitly non-permissible EXCEPT:
- (A) Remittance towards banned or proscribed magazines.
 - (B) Purchase of Foreign Currency Convertible Bonds (FCCBs) issued by Indian companies abroad.
 - (C) Remittance towards the purchase of Objects of Art subject to the Foreign Trade Policy.
 - (D) Remittance of interest income on funds held in Non Resident Special Rupee accounts.

Oct/Nov 2024

63. The following question consists of two statements – Assertion (A) and Reason (R). Answer this question selecting the appropriate option given below:
- Assertion (A): Resident individuals can freely remit funds to overseas exchanges for margin calls without any regulatory cap.
- Reason (R): Remittances for margins or margin calls to overseas exchanges are classified as non-permissible remittances.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2017

64. Regarding the definition of a “relative” for gifting under the Liberalised Remittance Scheme, all of the following are excluded EXCEPT:
- (A) Step daughter
 - (B) Father’s father
 - (C) Sister’s husband
 - (D) Step son

Oct/Nov 2005

65. The following question consists of two statements – Assertion (A) and Reason (R). Answer this question selecting the appropriate option given below:
- Assertion (A): An Authorized Dealer will deduct

TCS at the rate of 10% on an LRS remittance if the remitter fails to provide a PAN or Aadhar.
Reason (R): The standard Tax Collected at Source (TCS) rate on foreign remittance under LRS is 5% on amounts exceeding Rs 7 lakhs in a financial year.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

66. Loans extended by resident individuals to NRI close relatives must comply with several utilization constraints. Such loans shall NOT be utilized for all of the following activities EXCEPT:

- (A) Business of chit funds or Nidhi funds which are restricted under current banking regulations.
- (B) Agricultural or plantation activities involving the management of various farming land assets.
- (C) Meeting the borrower's personal requirements or for standard business purposes.
- (D) Trading in Transferable Development Rights (TDRs) restricted in specific municipal zones.

Oct/Nov 2015

67. Mr. Sharma runs a sole proprietorship firm, 'Sharma Traders'. He intends to remit USD 150,000 for attending specialized international business conferences and training. He asks his Authorized Dealer (AD) Bank to debit his firm's current account for this remittance under the Liberalised Remittance Scheme (LRS). How should the AD Bank process this request?

- (A) The AD Bank should allow the remittance by reckoning the eligibility of Mr. Sharma in his individual capacity against his USD 250,000 limit.
- (B) The request must be rejected as sole proprietorship firms are considered corporate entities and are ineligible for LRS.
- (C) The firm must first convert its current account into an Exchange Earners Foreign

Currency (EEFC) account before processing.
(D) The AD Bank must seek prior approval from the Ministry of Finance since it involves specialized international business training.

May/June 2013

68. What is the most appropriate valuation requirement for a resident individual investing less than USD 5 Million in an existing overseas Joint Venture?

- (A) A valuation certificate from a registered Category I Merchant Banker.
- (B) An independent audit by the financial regulator of the host country.
- (C) A standard declaration by the resident individual countersigned by the Authorized Dealer.
- (D) A valuation certificate provided by a Chartered Accountant or a Certified Public Accountant.

Oct/Nov 2021

69. Rohan has secured admission into a foreign university and obtains an educational loan from a financial institution to fund his studies. He requests a remittance of Rs 12,00,000 for tuition fees. What is the correct application of TCS by the Authorized Dealer (AD) Bank for this transaction?

- (A) 5% tax will be collected on Rs 5,00,000.
- (B) 0.5% tax will be collected on Rs 12,00,000.
- (C) 0.5% tax will be collected on Rs 5,00,000.
- (D) No tax will be collected because educational loans are fully exempt from TCS provisions.

May/June 2024

70. What is the best description of the "Funds-in and funds-out" criteria checking performed by an Authorized Dealer Bank?

- (A) It requires matching every outward remittance with a corresponding inward remittance from the same party within the quarter.
- (B) It dictates that all funds leaving the account must be compensated by an equivalent inward remittance within 180 days.
- (C) Checking statement credits against transaction summaries and reviewing for any Suspicious Transaction Reports (STRs).
- (D) It is a specialized tax assessment procedure to calculate the exact TCS liability at the end of the financial year.

Oct/Nov 2008

71. Mr. Iyer intends to invest USD 6 Million to acquire shares in an existing unlisted Wholly Owned Subsidiary (WOS) abroad. Since the investment size is substantial, what specific compliance must the Authorized Dealer (AD) Bank ensure regarding the valuation of the WOS shares before processing the remittance?
- The valuation must be certified by any practicing Chartered Accountant in India who holds a valid certificate of practice.
 - Valuation must be by a registered Category I Merchant Banker or a similar authorized banker in the host country.
 - No formal valuation is required as the investment is directed towards a Wholly Owned Subsidiary under the automatic route.
 - The valuation certificate must be issued directly by the Reserve Bank of India or a designated state-level regulatory body.

May/June 2006

72. Arrange the following regulatory milestones in the correct chronological order:
- Introduction of the Liberalised Remittance Scheme (LRS).
 - Enactment of the Foreign Exchange Management Act (FEMA).
 - Formation of the Financial Action Task Force (FATF).
 - Enforcement of the Prevention of Money Laundering Act (PMLA).
- 3, 2, 1, 4
 - 2, 3, 4, 1
 - 3, 1, 2, 4
 - 2, 1, 3, 4

Oct/Nov 2017

73. Mrs. Kapoor wants to gift USD 15,000 to her step daughter who currently resides in Canada and holds a foreign currency account there. She cites the transaction as a permissible gift under LRS. How should the Authorized Dealer (AD) Bank treat this request?
- Reject the remittance as a step daughter is excluded from the definition of a relative for gifting under LRS.
 - Process the remittance as a step daughter is considered a close relative for LRS gifting purposes under current regulations.
 - Process the remittance but apply a mandatory

10% TCS due to the international nature of the gift and the recipient's location.

- Require Mrs. Kapoor to secure prior approval from the Ministry of Human Resources Development before the AD can process funds.

May/June 2008

74. Match the remittances permissible subject to government approval with the respective approving Ministry/Department.

List I: Remittance Type

- Cultural tours
- Advertisements in Foreign Print Media by State Governments
- Remittances towards Freights of Vessels chartered by PSUs
- Hiring charges of transponders by TV Channels

List II: Ministry/Department

- Ministry of Information & Broadcasting
 - Ministry of Surface Transport
 - Ministry of Finance
 - Ministry of Human Resources Development
- P-4, Q-3, R-2, S-1
 - P-3, Q-4, R-1, S-2
 - P-4, Q-2, R-3, S-1
 - P-2, Q-1, R-4, S-3

Oct/Nov 2013

75. An individual requires an immediate remittance of USD 300,000 to a hospital in the USA for urgent specialized medical surgery. Given that the amount exceeds the standard LRS limit, what is the prerequisite for the Authorized Dealer (AD) Bank to release this foreign exchange?
- AD Bank can release exchange based on formal estimates from a doctor in India or the hospital abroad.
 - The AD Bank must refuse the extra USD 50,000 as it strictly violates the maximum cap permitted for current account transactions.
 - The individual must temporarily surrender their residency status to access higher limits provided by the central regulatory body.
 - The remittance can only be approved if the funds are drawn from a non-interest-bearing Foreign Currency Account in an IFSC branch.

May/June 2015

76. Match the destination/category with the permissible release of foreign exchange in the form of foreign currency notes.

List I: Destination/Category

- P. Islamic Republic of Iran
Q. Iraq and Libya
R. All other countries
S. Haj Pilgrims

List II: Permissible Release (Foreign Currency Notes)

1. Up to the cash limit specified by the Haj Committee of India
 2. Full exchange may be released in the form of FC Notes
 3. USD 5,000
 4. USD 3,000
- (A) P-2, Q-3, R-4, S-1
(B) P-3, Q-2, R-1, S-4
(C) P-4, Q-1, R-3, S-2
(D) P-2, Q-4, R-3, S-1

Oct/Nov 2012

77. John, a citizen of the UK, has been living in India for the past two years on an employment deputation for a specific corporate project. He intends to remit a portion of his Indian salary back to the UK for family maintenance. Does he qualify for the LRS scheme?
- (A) No, only Indian citizens possessing a valid Aadhar card and permanent residency status are eligible for the LRS scheme.
(B) Yes, as a foreign citizen on employment for less than 3 years, he is eligible subject to taxes and contributions.
(C) No, foreign citizens must maintain a continuous residency of at least 5 years before accessing LRS benefits in the country.
(D) Yes, but he is restricted to a maximum remittance limit of USD 50,000 per financial year for personal maintenance purposes.

May/June 2011

78. Match the Overseas Direct Investment conditions with their respective procedural mandates.

List I: ODI Conditions

- P. Investment exceeding USD 5 Million in existing JV/WOS
Q. Disinvestment by resident individuals
R. Repatriation of dividends, royalties, and technical fees

- S. Submission of Annual Performance Reports (APRs)

List II: Procedural Mandates

1. Allowed only after one year from the date of making the first investment
 2. Must be done within 60 days of such amounts falling due
 3. Requires valuation by a Category I Merchant Banker
 4. Submitted every year before 31st December
- (A) P-3, Q-1, R-2, S-4
(B) P-1, Q-3, R-4, S-2
(C) P-3, Q-2, R-1, S-4
(D) P-2, Q-4, R-3, S-1

Oct/Nov 2020

79. An Indian resident invested USD 100,000 to set up a Wholly Owned Subsidiary (WOS) in Singapore. After 8 months of operations, he decides to completely disinvest and wind up the entity due to market conditions, planning to repatriate the funds back to India. What prevents the immediate execution of this disinvestment?
- (A) Disinvestments are not allowed to be repatriated to India and must be reinvested in another foreign entity.
(B) The resident individual must obtain a valuation certificate from a registered Category I Merchant Banker for any disinvestment.
(C) Winding up a WOS requires prior approval from international anti-money laundering authorities.
(D) Disinvestments are allowed only after one year from the date of making the first investment.

May/June 2022

80. Which of the following pairs correctly reflects the rule governing loans granted by resident individuals to NRI close relatives?
- (A) Interest rate applied — Subject to prevailing benchmark rates
(B) Utilization of loan — Permitted for real estate activities
(C) Repayment source — Allowed from overseas offshore accounts only
(D) Minimum maturity of loan — One year

ANSWERS

1. (B) Any funds lying idle in the account for up to 15 days from credit must be repatriated to the domestic INR account.
Resident individuals can open a non-interest-bearing Foreign Currency Account in an International Financial Services Centre for permitted investments. However, regulatory guidelines mandate that any funds lying idle in such accounts for more than fifteen days from the date of credit must be repatriated to the domestic Indian Rupee account of the investor immediately to ensure compliance.
2. (C) Permanent Account Number (PAN) — Mandatory only for remittances above USD 250,000.
Under the Liberalised Remittance Scheme, providing a Permanent Account Number is a mandatory requirement for all transactions, regardless of the remittance amount. This ensures proper tracking of foreign exchange outflows and tax compliance. Other documentation like Form A2 can be submitted online, and simplified processes exist for individuals making smaller remittances up to twenty-five thousand dollars for ease.
3. (A) A parent remitting funds to a dependent child abroad towards education expenses and maintenance.
Current account transactions involve payments that do not alter the assets or liabilities of a person outside India. Remitting funds for education expenses and maintenance of a dependent child living abroad is a classic example of such a transaction. In contrast, investments in overseas equity or purchasing immovable property are classified as capital account transactions due to asset creation.
4. (A) Only I
Resident individuals making overseas direct investments are subject to specific lock-in periods. Disinvestments are generally permitted only after the completion of one year from the date of making the first investment in the foreign entity. This ensures stability in overseas ventures.
Furthermore, unlike corporate entities, resident individuals are not permitted to write-off capital losses incurred during such disinvestment.
5. (D) Members of an HUF, spouses, or those related as father, mother, son, or daughter in a specifically prescribed manner.
For the purpose of foreign exchange regulations, the term relative is defined specifically to include members of a Hindu Undivided Family, spouses, and individuals related as father, mother, son, or daughter. This definition determines the eligibility for various Home like gifting or providing interest-free loans to Non-Resident Indians who fall within these specific categories under the framework.
6. (C) Both I and II
Students proceeding abroad for higher studies are designated as Non-Resident Indians under foreign exchange laws. This status grants them specific facilities, including the ability to remit up to one million US dollars per financial year from their Non-Resident Ordinary accounts. Such remittances are permitted provided the funds represent legitimate dues or income earned by the student within India.
7. (B) Up to thrice the amount involved in the contravention.
Penalties for contravening foreign exchange regulations are structured based on whether the amount involved is quantifiable. If the contravention amount is identifiable, the maximum penalty can extend up to three times that specific amount. This stringent measure serves as a deterrent against unauthorized transactions, ensuring that individuals and entities adhere strictly to the prescribed limits and procedural requirements.
8. (B) II and III only
Resident individuals can extend loans to Non-Resident Indian close relatives under specific conditions. The loan must be interest-free and have a minimum maturity period of one year. While the proceeds can be credited to the

- borrower's Non-Resident Ordinary account in India, the funds should be used for the borrower's personal requirements or own business purposes within India.
9. (B) USD 5,000
While the general limit for releasing foreign exchange in the form of currency notes to travelers is three thousand dollars, specific exceptions apply to certain destinations. For individuals proceeding to Iraq or Libya, authorized dealers are permitted to release foreign currency notes up to a maximum limit of five thousand dollars. This provision caters to the specific financial environments.
 10. (C) I and III only
Remittances for emigration can exceed the standard annual limit if the country of emigration mandates a higher amount for incidental expenses or meeting specific entry requirements. Individuals must provide documentary evidence to satisfy the authorized dealer regarding these requirements. However, using these funds solely to earn immigration points through foreign government bond investments without a mandatory requirement is restricted.
 11. (A) Foreign exchange must be used for the permissible purpose or surrendered within a specified period if unused.
Foreign exchange acquired by a resident for a specific purpose must be utilized for that intent or surrendered to an authorized dealer within a prescribed timeframe. For unutilized currency notes, the surrender period is typically one hundred and eighty days from the date of return. This ensures that foreign exchange reserves are managed efficiently and not held indefinitely.
 12. (B) I, III, and IV only
Resident individuals making overseas direct investments must comply with several operational guidelines. Investments are allowed in both listed and unlisted entities, provided the overseas joint venture is an operating entity rather than a shell company. Investors must submit share certificates within six months. Notably, investments in countries identified as non-compliant by the Financial Action Task Force are restricted.
 13. (B) They are considered NRIs, and their existing resident account needs to be designated as an NRO account.
Students moving abroad for higher education are treated as Non-Resident Indians for the duration of their stay. Consequently, they are required to re-designate their existing domestic savings accounts as Non-Resident Ordinary accounts. This change in status allows them to manage their Indian income, such as rent or interest, and remit funds abroad under the specific limits.
 14. (B) I, III, and IV only
The Liberalised Remittance Scheme mandates a Permanent Account Number for all transactions to ensure transparency. While the scheme is available to resident individuals and certain foreign citizens on short-term employment, the annual limit of two hundred and fifty thousand dollars is absolute. Any amount exceeding this threshold requires prior regulatory approval, and bringing back previous investment proceeds does not replenish the annual limit for further remittances.
 15. (D) Foreign bank guarantees towards overseas employers or immigration are strictly not permitted.
Regulations strictly prohibit the issuance of foreign bank guarantees for certain purposes under the Liberalised Remittance Scheme. Specifically, guarantees intended for overseas employers or to facilitate immigration processes are not allowed. Authorized dealers must ensure that remittances are not used to provide such financial backings, as the scheme is designed for genuine personal consumption and permitted investments.
 16. (B) I, II, and IV only
Violations of foreign exchange regulations are met with significant penalties. For quantifiable amounts, the fine can be up to three times the value involved. Non-quantifiable contraventions are capped at two lakh rupees. For continuing defaults, an additional daily penalty is levied for each day after the initial breach. These measures ensure that individuals maintain strict compliance with the framework.

- 17.** (B) These expenses fall outside the purview of the Liberalised Remittance Scheme and may be permitted without any limit.
When a resident individual undertakes a business trip where all expenses are borne by the employing company, such remittances are treated as being outside the purview of the Liberalised Remittance Scheme. Consequently, these transactions do not consume the individual's annual limit of two hundred and fifty thousand dollars. Such expenses are permitted without a specific limit for business.
- 18.** (B) I, III, and IV only
Under the Liberalised Remittance Scheme, the definition of a relative is restricted to specific family members. This includes parents, spouses, siblings, and children. For gifting purposes, individuals like a father, son, or sister are considered close relatives. However, certain extended family members, such as a brother's wife or a daughter's son, do not fall within this definition.
- 19.** (A) TCS is applicable to all remittances by non-individuals and for payment of import of goods and services.
Tax Collected at Source provisions apply specifically to remittances made by resident individuals under the Liberalised Remittance Scheme. The threshold for such collection is seven lakh rupees per financial year. While specific rates exist for education and medical purposes, the claim that TCS applies to all remittances by non-individuals and for every import of goods or services is incorrect.
- 20.** (A) I, II, III, and V only
Authorized dealers can release foreign exchange for various current account purposes. For private visits, cash up to fifty thousand rupees is accepted. Travelers to the Russian Federation may receive their full exchange in currency notes. While remittances for studies and emigration can exceed standard limits based on documentation, medical treatments below the annual threshold do not strictly require estimates.
- 21.** (D) Domestic transactions are freely permissible to be settled with other residents through Foreign Currency Accounts held in IFSCs.
Resident individuals are allowed to open non-interest-bearing Foreign Currency Accounts in International Financial Services Centres for overseas investments. While they can invest in various foreign securities, the funds cannot be used to settle domestic transactions with other residents. Regulatory rules mandate that any idle funds must be repatriated to a domestic rupee account within fifteen days for compliance.
- 22.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The Liberalised Remittance Scheme is inclusive and allows all resident individuals, including minors, to avail of foreign exchange facilities up to two hundred and fifty thousand dollars annually. For minors, the LRS declaration form must be countersigned by their natural guardian. This ensures that younger residents can meet educational or other personal needs abroad while adhering to all necessary documentation.
- 23.** (B) Resident Individuals including Minors
Eligibility for the Liberalised Remittance Scheme is strictly limited to resident individuals, which explicitly includes minors when represented by a guardian. Other entities, such as partnership firms, Hindu Undivided Families, and charitable trusts, are not permitted to make remittances under this specific scheme. This distinction ensures that the liberalization of foreign exchange is targeted toward the personal requirements of residents.
- 24.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
Students pursuing education overseas are classified as Non-Resident Indians under foreign exchange regulations due to their residence outside India for an uncertain period. As NRIs, they possess the facility to remit up to one million dollars per year from their Indian accounts. Although both facts are correct, the remittance limit is a consequence of their status rather than the reason.

25. (A) Bonafide manufacturing activities

Resident individuals are permitted to make direct investments in overseas entities engaged in various sectors, provided they are not specifically prohibited. Manufacturing activities are generally allowed under the automatic route. However, investments in sectors like real estate business, banking, or financial service activities are restricted for individuals to prevent excessive risk and maintain regulatory control over capital outflows into sensitive industries.

26. (C) Assertion (A) is true, but Reason (R) is false.

Direct investment by resident individuals in an overseas joint venture involved in the real estate business is strictly prohibited to prevent speculative capital outflows. However, the reasoning that such investments are limited only to listed companies is incorrect. Regulatory guidelines allow for investments in both listed and unlisted overseas entities, provided they are engaged in permissible operating activities and ventures.

27. (A) Carry out thorough due diligence regarding the opening and maintenance of the account.

When an individual seeking to remit funds under the Liberalised Remittance Scheme is a new customer, authorized dealers must exercise enhanced caution. The bank is required to carry out thorough due diligence regarding the opening and maintenance of the account. This process ensures that the source of funds is legitimate and that the transaction complies with all required guidelines.

28. (B) 5% tax will be collected on Rs 4,50,000.

Tax Collected at Source is calculated on the aggregate amount remitted by an individual during a financial year. Since the total remittance of eleven lakh fifty thousand rupees exceeds the seven lakh threshold, tax is applicable on the excess amount. For the second transaction of five lakhs, tax at five percent will be collected on four lakh fifty thousand rupees.

29. (B) Authorized Dealers may release exchange based on formal estimates from a doctor in India or the hospital abroad.

For medical treatment abroad, authorized dealers have the power to release foreign exchange exceeding the standard annual limit. This is

permitted based on formal estimates provided by a doctor in India or the hospital located overseas. Such provisions ensure that individuals can access necessary healthcare without being constrained by usual limits, provided the requirement is backed by authentic medical documentation.

(C) They must comply with terms individually and both must be registered co-owners of the overseas property.

Family members are permitted to consolidate their individual limits under the Liberalised Remittance Scheme for capital account transactions, such as purchasing immovable property abroad. To successfully complete such a transaction, each participating member must be a registered co-owner of the property. This ensures that the remittance is genuinely for a joint asset and that each individual's contribution is documented.

31. (D) Any funds lying idle in the account for up to 15 days from credit must be repatriated to the investor's domestic INR account.

Funds held in a Foreign Currency Account within an International Financial Services Centre must be utilized for permitted investments. If these funds remain idle for more than fifteen days from the date of credit, they must be repatriated to the investor's domestic rupee account in India. This regulation prevents the indefinite holding of foreign currency in offshore accounts without active use.

32. (D) Reject the request as payments for margin calls to overseas exchanges are explicitly prohibited.

Remittances for margins or margin calls to overseas exchanges are explicitly classified as non-permissible transactions under the Liberalised Remittance Scheme. Such activities are viewed as speculative and are restricted to protect resident individuals from high-risk international trading. Therefore, authorized dealers must reject any request to transfer funds for this purpose, even if the amount is within the annual limit.

33. (A) 3, 4, 1, 2

Compliance for overseas direct investments follows a specific chronological order to ensure regulatory oversight. Initially, the investor must submit Part One of Form ODI

at the time of remittance. This is followed by submitting share certificates as evidence of investment. Subsequently, Annual Performance Reports must be filed periodically to track the venture's progress. Finally, any proceeds from disinvestment are repatriated.

- 34.** (C) Deepak can remit up to USD 1 Million per year; the excess amount requires specific regulatory approval.

Individuals designated as Non-Resident Indians, including students studying abroad, are subject to different remittance rules compared to resident individuals. While the Liberalised Remittance Scheme limit is two hundred and fifty thousand dollars, NRIs can remit up to one million dollars per financial year from their NRO accounts. Any amount exceeding this specific million-dollar threshold for purchases requires regulatory approval.

- 35.** (A) P-3, Q-4, R-1, S-2

Foreign exchange regulations are organized into specific sections that define the powers of the regulator and the rights of residents. General restrictions on holding foreign exchange are outlined to maintain economic stability, while capital account transactions are governed by specific limits. The Reserve Bank of India holds the power to issue directions to authorized persons, and clear penalties exist for contraventions.

- 36.** (D) Loans provided by resident individuals to NRI close relatives must be interest-free.

Resident individuals are allowed to provide loans to Non-Resident Indian close relatives under the Liberalised Remittance Scheme, provided certain conditions are met. A primary requirement is that such loans must be interest-free. Any agreement that includes a specified interest rate, such as five percent, will be rejected by an authorized dealer as it violates the regulatory framework for familial support.

- 37.** (A) P-3, Q-4, R-1, S-2

The application of Tax Collected at Source varies based on the amount, purpose, and documentation provided. Remittances below seven lakh rupees do not attract tax. For amounts exceeding this threshold, a five percent rate applies if a Permanent Account Number is available. However, education loans enjoy a lower

rate of zero point five percent, while missing documentation triggers ten percent.

- 38.** (C) He is required to surrender the unutilized foreign exchange to the AD within 180 days from his return to India.

Upon returning to India from an international trip, resident individuals are required to manage their unutilized foreign exchange according to specific timelines. Any foreign currency notes that were not spent during the visit must be surrendered to an authorized dealer. The mandated period for this surrender is within one hundred and eighty days from the date of the individual's return.

- 39.** (B) Going abroad for employment — Permissible remittance under delegated powers of Authorized Dealers.

Various transactions are categorized under foreign exchange laws to regulate the outflow of currency. While remittances for lottery tickets and call-back services are strictly prohibited, traveling abroad for employment is a permissible purpose. Authorized dealers have the delegated power to process remittances for individuals moving overseas for work, ensuring they have the necessary funds for their transition and maintenance.

- 40.** (A) Ministry of Finance

State Government Public Sector Undertakings must obtain specific government approval before remitting funds for certain activities. For advertisement campaigns in foreign print media, particularly those for purposes other than attracting foreign direct investment, the mandatory approval must be sought from the Ministry of Finance. This ensures that such significant expenditures by government-owned entities are aligned with national economic and exchange management goals.

- 41.** (A) Sister's husband — Included as a relative
The definition of a relative for gifting under the Liberalised Remittance Scheme is specifically derived from the Companies Act. While it includes family members like step-parents and spouses of children, it excludes certain in-laws. For instance, a sister's husband is not classified as a relative under these guidelines. Correctly

identifying these relationships is essential for authorized dealers when processing remittances.

- 42. (B)** A transaction altering assets or liabilities, including contingent liabilities, outside India of persons resident in India.

A capital account transaction is defined by its impact on the assets or liabilities of a person. Specifically, it involves any transaction that alters assets or liabilities, including contingent liabilities, situated outside India for a resident individual, or inside India for a non-resident. Examples include purchasing immovable property abroad or making direct investments in foreign companies, distinguishing them from current.

- 43. (B)** Only II

Issuing foreign bank guarantees under the Liberalised Remittance Scheme is subject to strict limitations. While the scheme allows for various personal and investment remittances, it does not permit the issuance of guarantees for purposes such as overseas employment or immigration. Furthermore, guarantees for educational purposes in favor of universities are also generally restricted, as the scheme focuses on direct fund.

- 44. (C)** Investment via contribution to capital or subscription to the Memorandum of Association of a foreign entity.

Direct investment outside India by a resident individual refers to a long-term interest in a foreign entity. This typically involves making a contribution to the capital of the entity or subscribing to its Memorandum of Association. Such investments are distinct from portfolio investments, which involve buying shares for short-term gains, and focus on establishing a lasting participation in an overseas business.

- 45. (A)** Only I

Family members can combine their individual limits under the Liberalised Remittance Scheme to facilitate larger capital account transactions, such as buying property overseas. However, a key requirement is that all participating family members must be registered as co-owners of the acquired asset. Additionally, authorized dealers are strictly prohibited from providing any credit facilities to residents to fund these remittances.

- 46. (C)** 4th February 2004

The Liberalised Remittance Scheme was introduced by the Reserve Bank of India on February 4, 2004. This landmark scheme was designed to simplify the process for resident individuals to remit funds abroad for various permissible current and capital account transactions. Initially launched with a smaller limit, the scheme has since evolved, providing residents with greater flexibility in managing global interests.

- 47. (B)** I and III only

Tax Collected at Source on foreign remittances is governed by specific thresholds and rates. A threshold of seven lakh rupees per financial year applies before tax collection begins. For remittances funded through educational loans from financial institutions, a concessional rate of zero point five percent is applied. Notably, these TCS provisions under the scheme are primarily applicable to resident individuals.

- 48. (D)** Within 180 days

Resident individuals returning to India must adhere to specific rules regarding unspent foreign currency. Any foreign exchange acquired for a trip that remains unutilized must be surrendered to an authorized dealer. The regulatory timeframe for this action is within one hundred and eighty days of the individual's return. This ensures that foreign currency is reintegrated into the formal banking system.

- 49. (A)** I and II only

Authorized dealers are required to follow strict reporting protocols for transactions under the Liberalised Remittance Scheme. They must upload daily transaction-wise information onto a dedicated digital platform. This reporting should be completed by the close of business on the next working day. Even if no transactions occur, a NIL report must still be filed to ensure continuous regulatory oversight.

- 50. (C)** Resident Individuals including Minors

The Liberalised Remittance Scheme is specifically designed for resident individuals, including minors who act through a natural guardian. Other entities, such as registered partnership firms, incorporated bodies, or non-resident Indians, are not eligible to avail of the facilities offered

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under this particular scheme. This ensures that the liberalization of foreign exchange remains focused on the personal needs and investments of residents.

51. (B) II and III only

Under the Liberalised Remittance Scheme, resident individuals are permitted to remit funds for purchasing objects of art. This is allowed for personal purposes that are not related to trade or commercial activities. However, such purchases must comply with the conditions and guidelines laid out in the prevailing Foreign Trade Policy to ensure that the importation of these items follows regulations.

52. (D) The eligibility of the proprietor in his individual capacity is reckoned to allow the remittance.

For the purpose of the Liberalised Remittance Scheme, a sole proprietorship firm is not treated as a separate legal entity. Therefore, when such a firm intends to remit funds, the eligibility is determined based on the proprietor in their individual capacity. The remittance amount is deducted from the proprietor's personal annual limit of two hundred and fifty thousand dollars per financial year.

53. (B) II, III, and IV only

Resident individuals can open non-interest-bearing Foreign Currency Accounts in International Financial Services Centres. While these accounts facilitate overseas investments, the funds must not be used to settle domestic transactions with other residents. Furthermore, if the funds remain idle for more than fifteen days, they must be repatriated to India. Investments are limited to securities not issued by resident entities.

54. (C) There are no restrictions on the frequency of remittances within a financial year as long as the total does not exceed USD 250,000.

The Liberalised Remittance Scheme allows resident individuals to make foreign exchange transfers with significant flexibility. There are no restrictions on the frequency of remittances throughout a financial year, provided the total amount does not exceed two hundred and fifty thousand dollars. This allows individuals to manage multiple personal or investment needs

abroad efficiently while staying within the overall annual regulatory limit.

55. (A) I, II, and III only

Certain types of remittances are strictly prohibited to maintain financial stability and prevent speculative activities. These include payments for margins or margin calls on overseas exchanges and telephone call-back services. Additionally, companies subject to dividend balancing requirements are not permitted to remit dividends. Such restrictions ensure that foreign exchange outflows are directed toward legitimate and approved personal or business transactions.

56. (A) Disinvestments must be repatriated to India no later than 60 days from the date of disinvestment.

When a resident individual chooses to disinvest from an overseas direct investment, they must follow specific repatriation rules. The proceeds from the disinvestment are required to be brought back to India no later than sixty days from the date the disinvestment was completed. This timeline ensures that capital returned from foreign ventures is properly accounted for within the domestic financial system.

57. (A) I, II, III, and V only

Documentation for the Liberalised Remittance Scheme has been streamlined to facilitate easier transactions. Form A2 can be submitted online, and simplified documentation is available for smaller amounts. Remitters must declare the source of their funds to ensure transparency. Furthermore, tax collected at source is applicable when individuals purchase overseas tour packages through operators, regardless of the usual threshold limit.

58. (B) Payment of commission on exports made towards equity investments in Joint Ventures abroad is freely permitted.

Foreign exchange regulations explicitly list several prohibited remittances to prevent unauthorized outflows. Prohibitions include lottery winnings, income from racing, and payments for margin calls to overseas exchanges. While most commercial commissions are allowed, paying a commission on exports that are utilized for equity investments in a joint venture

abroad is generally restricted. Understanding these exclusions is vital for ensuring compliance.

59. (B) I, III, IV, and V only

Resident individuals can engage in various capital account transactions under the Liberalised Remittance Scheme. These include purchasing immovable property abroad, extending interest-free INR loans to NRI close relatives, and opening foreign currency accounts overseas for investment purposes. Individuals may also acquire qualification shares to serve as directors. However, direct investment in overseas companies specifically engaged in real estate remains prohibited.

60. (C) A NIL report is not required to be uploaded even if there are no transactions on a particular business day.

Authorized dealers must maintain a rigorous reporting schedule for all transactions conducted under the Liberalised Remittance Scheme. This involves uploading daily transaction-wise data onto a digital platform by the next working day. The regulatory requirement is absolute, meaning that even if no transactions occur on a given day, the bank must still upload a NIL report to confirm inactivity.

61. (A) I, II, and IV only

When processing remittances, authorized dealers must perform comprehensive due diligence to ensure the legitimacy of funds. This includes examining account statements for previous credits and reviewing any Suspicious Transaction Reports associated with the client. Banks are also responsible for framing clear customer interface guidelines. However, individuals on regulatory caution or defaulter lists are generally restricted from making overseas investments.

62. (C) Remittance towards the purchase of Objects of Art subject to the Foreign Trade Policy.

While many transactions are restricted under foreign exchange laws, some specialized purchases are permitted. Resident individuals are allowed to remit funds for the purchase of objects of art, provided they comply with the Foreign Trade Policy. In contrast, remittances for proscribed magazines, interest on certain non-resident accounts, or purchasing Indian company

bonds issued abroad are typically classified as non-permissible.

63. (D) Assertion (A) is false, but Reason (R) is true.

The Liberalised Remittance Scheme does not allow resident individuals to transfer funds to overseas exchanges for the purpose of meeting margin calls. Such transactions are classified as non-permissible due to their speculative nature and the high risk involved in international commodity or security trading. Consequently, authorized dealers must refuse any such requests, as they violate the core principles of regulation.

64. (D) Step son

For the purpose of making gift remittances, the term relative is defined by the Companies Act and includes specific immediate family members. This list features parents, spouses, siblings, and children, along with their spouses. Notably, while a step-son is recognized as a relative under these guidelines, other relations such as a step-daughter, a father's father, or a sister's husband are excluded from this definition.

65. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Authorized dealers are required to collect tax at source for remittances exceeding seven lakh rupees. While the standard rate is five percent, this increases to ten percent if the remitter fails to provide a Permanent Account Number or Aadhar. Both statements correctly reflect the tax regulations; however, the standard rate itself does not provide the logical basis for the penalty.

66. (C) Meeting the borrower's personal requirements or for standard business purposes.

Loans provided by resident individuals to Non-Resident Indian close relatives are subject to strict utilization rules. The funds are prohibited from being used for speculative activities such as chit funds, agricultural or plantation activities, or trading in Transferable Development Rights. However, the borrower is permitted to use the loan proceeds for their own personal requirements or for legitimate business purposes within India.

- 67.** (A) The AD Bank should allow the remittance by reckoning the eligibility of Mr. Sharma in his individual capacity against his USD 250,000 limit. When a sole proprietor seeks to remit funds for business-related training or conferences, the transaction is treated as a personal remittance of the individual owner. Authorized dealers should process such requests by checking the proprietor's personal limit under the Liberalised Remittance Scheme. This ensures that the individual can meet professional development needs while staying within the annual two hundred and fifty thousand dollar limit.
- 68.** (D) A valuation certificate provided by a Chartered Accountant or a Certified Public Accountant. For resident individuals investing in an existing overseas joint venture, specific valuation requirements apply based on the investment size. If the total investment is less than five million US dollars, a valuation certificate from a practicing Chartered Accountant or a Certified Public Accountant is sufficient. This provides a formal assessment of the investment's value while keeping compliance manageable for smaller-scale ventures.
- 69.** (C) 0.5% tax will be collected on Rs 5,00,000. When a remittance for studies abroad is funded through an educational loan from a financial institution, a lower tax rate is applied. For a twelve lakh rupee transfer, the first seven lakhs are exempt from Tax Collected at Source. The remaining five lakh rupees attract tax at a rate of zero point five percent, ensuring students face lower costs.
- 70.** (C) Checking statement credits against transaction summaries and reviewing for any Suspicious Transaction Reports (STRs). The funds-in and funds-out criteria is a due diligence process used by authorized dealers to monitor account activity. It involves a systematic check of statement credits against the summaries of transactions provided by the customer. Furthermore, the bank must review the account for any filed Suspicious Transaction Reports. This practice helps identify potential money laundering and ensures legitimacy.
- 71.** (B) Valuation must be by a registered Category I Merchant Banker or a similar authorized banker in the host country. Significant overseas investments by resident individuals require higher levels of financial scrutiny. If the investment in an existing unlisted foreign entity exceeds five million US dollars, a formal valuation is mandatory. This valuation must be certified by a registered Category One Merchant Banker in India or an equivalent authorized banker in the host country to ensure the transaction's financial integrity.
- 72.** (A) 3, 2, 1, 4
The evolution of financial regulations followed a specific timeline to address global and domestic economic needs. The Financial Action Task Force was formed in 1989 to combat money laundering. This was followed by India's enactment of the Foreign Exchange Management Act in 1999. Subsequently, the Liberalised Remittance Scheme was introduced in 2004, followed by enforcement of the PMLA.
- 73.** (A) Reject the remittance as a step daughter is excluded from the definition of a relative for gifting under LRS. Gift remittances under the Liberalised Remittance Scheme are only permitted for individuals who meet the regulatory definition of a relative. According to the Companies Act, which provides this definition, a step-daughter is not included as a close relative. Therefore, an authorized dealer must reject a request to gift funds to a step-daughter, as she does not fall within eligibility.
- 74.** (A) P-4, Q-3, R-2, S-1
Specific current account remittances by government entities or for specialized purposes require approval from relevant ministries. Cultural tours are overseen by the Ministry of Human Resources Development, while advertisements by State Governments require Finance Ministry clearance. The Ministry of Surface Transport manages PSU vessel freights, and the Ministry of Information and Broadcasting approves transponder hiring charges for television channels abroad.

- 75.** (A) AD Bank can release exchange based on formal estimates from a doctor in India or the hospital abroad.
In cases of urgent medical necessity, authorized dealers are empowered to release foreign exchange that exceeds the standard annual limit. For specialized surgeries abroad, the bank can approve the additional amount based on formal cost estimates from a domestic doctor or the overseas hospital. This flexibility ensures that life-saving treatments are not delayed by administrative limits, provided authentic medical documentation exists.
- 76.** (A) P-2, Q-3, R-4, S-1
The amount of foreign exchange released in the form of currency notes varies by destination. While most countries have a three thousand dollar limit, travelers to Iraq and Libya can receive up to five thousand dollars. Those proceeding to the Islamic Republic of Iran may receive their full exchange in cash. Additionally, Haj pilgrims are governed by specific cash limits specified.
- 77.** (B) Yes, as a foreign citizen on employment for less than 3 years, he is eligible subject to taxes and contributions.
Foreign citizens residing in India for employment purposes are eligible to avail of the Liberalised Remittance Scheme under certain conditions. Specifically, if the individual has been resident in India for less than three years, they can remit funds for personal purposes. This provision allows expatriates to manage their international financial obligations while working in India, provided they comply with tax laws.
- 78.** (A) P-3, Q-1, R-2, S-4
Overseas direct investment involves several procedural mandates to ensure compliance and oversight. Investments exceeding five million dollars require valuation by a merchant banker. Disinvestments are typically allowed only after one year of the initial investment. Investors must also ensure that income like dividends is repatriated within sixty days and that Annual Performance Reports are submitted by the end of December.
- 79.** (D) Disinvestments are allowed only after one year from the date of making the first investment. Resident individuals who have made an overseas direct investment are subject to a minimum holding period before they can disinvest. The regulatory framework mandates that such investments must be held for at least one year from the date the first remittance was made. Therefore, an attempt to wind up a wholly owned subsidiary and repatriate funds after only eight months.
- 80.** (D) Minimum maturity of loan — One year.
Loans extended by resident individuals to Non-Resident Indian close relatives are governed by specific terms. One of the mandatory requirements is that the loan must have a minimum maturity period of one year. Furthermore, the loan must be provided interest-free and the proceeds should not be used for prohibited activities such as real estate business or agricultural ventures in India.

CHAPTER 03

Correspondent Banking and NRI Accounts

May/June 2011

1. An NRI, who had opened a Public Provident Fund (PPF) account while he was a resident, wishes to know if he can continue to operate it. Additionally, he wants to start intra-day trading in securities on the Indian stock market. According to the regulations on prohibited transactions, what is the correct regulatory position?

- (A) He must immediately close the PPF account, but he can freely engage in intra-day trading.
- (B) He can operate the PPF account, but intra-day trading is prohibited.
- (C) He can continue the PPF account and also engage in intra-day trading without any restrictions.
- (D) Both continuing the existing PPF account and intra-day trading are strictly prohibited under FEMA.

Oct/Nov 2018

2. Identify the correct pair regarding the conversion/designation of accounts when residential status changes.

- (A) Resident becoming a non-resident → Existing resident account immediately converted into an RFC account.
- (B) Non-resident returning for permanent settlement → NRE account immediately converted into an FCNR account.
- (C) Resident becoming a non-resident → Existing resident account immediately converted into an NRO account.
- (D) Non-resident returning for permanent settlement → SNRR account converted into an NRE account.

May/June 2023

3. Correspondent banking allows banks to handle business in another city or country through local banks acting as agents and charging fees for the services rendered. What primary requirement does this system eliminate for the respondent bank?

- (A) The need to have a global network of branches
- (B) The need to offer foreign exchange derivative products
- (C) The need to process outward payments manually
- (D) The need to maintain an account with the host country's central bank

Oct/Nov 2009

Match the items in List I with those in List II.

List I: (NRI Accounts)

- P. NRE Account
- Q. NRO Account
- R. FCNR (B) Account
- S. SNRR Account

List II: (Defining features)

- 1. Maintained in foreign currency, accepted only in the form of Term Deposits.
- 2. Maintained in Indian Rupees, used for bona fide transactions related to a business interest in India, tenure not exceeding 7 years.
- 3. Maintained in Indian Rupees, permits full repatriation of deposit amount including interest, exchange risk lies with depositor.
- 4. Maintained in Indian Rupees, used to route legitimate domestic earnings like rent, repatriable up to USD 1 million per FY.

- (A) P-1, Q-2, R-3, S-4
- (B) P-4, Q-3, R-2, S-1
- (C) P-3, Q-1, R-4, S-2
- (D) P-3, Q-4, R-1, S-2

May/June 2007

5. Correspondent banks provide various account services that require having an account relationship with the foreign bank. Which of the following is NOT classified under Clearing House functions?

- (A) Providing an intra-day line of credit for approval of payment instructions
- (B) Handling of outward payments and receipt of inward payments

- (C) Efficiently handling reimbursement of LC claims and cheque collections on the account
- (D) Noting and protesting bills of exchange for the respondent bank

Oct/Nov 2014

6. A foreign national holding a valid visa and valid residential permit issued by the FRO/FRRO wishes to open an NRO account. If this individual is of Bangladesh nationality, what is the regulatory requirement?
- (A) They require prior approval of the Reserve Bank of India regardless of their current visa status.
 - (B) They are strictly prohibited from opening any type of bank account for local currency in India.
 - (C) They may open the account with a valid visa and permit without prior RBI approval.
 - (D) They can only open an SNRR account for business purposes, and not a standard NRO account.

May/June 2019

7. Identify the correct statement regarding the overdrafts and loan facility provided by a correspondent bank.
- (A) Overdrafts for temporary funding gaps are granted without any requirement for execution of agreements.
 - (B) The correspondent bank grants overdrafts for temporary overnight needs to fill up short-term funding gaps.
 - (C) The correspondent bank can grant regular short-term loans based solely on the respondent bank's domestic customer deposits.
 - (D) Overdraft facilities are provided independently of any account relationship between the client bank and the correspondent bank.

Oct/Nov 2006

8. Consider the following statements regarding the NRO account of a foreign tourist visiting India:
- I. It can be opened with funds remitted from outside India through banking channels.
 - II. It can be opened by sale of foreign exchange brought by him to India.
 - III. Balances can be converted back to foreign currency and paid to the account holder at

departure.

- IV. The account must not be maintained for a period exceeding six months.
- V. The account can be freely credited with local funds obtained from business activities in India.

Which of the above statements are correct?

- (A) Only I, II, III, and IV
- (B) Only II, III, IV, and V
- (C) Only I, III, and V
- (D) All I, II, III, IV, and V

May/June 2021

9. A commercial bank in India wishes to assist its corporate client in arranging a supplier's credit in Germany and requires credit reports on a foreign party. The Indian bank does not maintain any account in Germany. Can the Indian bank access these services through a correspondent bank?
- (A) Yes, as these 'Other Services' do not normally require an account relationship.
 - (B) Yes, provided the bank establishes a VOSTRO account and maintains high balances.
 - (C) No, because all correspondent banking services require a pre-funded mirror account.
 - (D) No, as gathering credit reports on foreign parties is strictly prohibited under FEMA rules.

Oct/Nov 2010

10. Arrange the sequential steps an Authorized Dealer Category-I bank follows to facilitate a foreign national collecting pending bona fide dues after leaving their employment in India:
- I. Debit the account solely for the purpose of repatriation abroad.
 - II. Repatriate funds abroad immediately, ensuring it does not exceed USD 1 million per financial year.
 - III. Close the account immediately after all dues have been received and repatriated.
 - IV. Re-designate the resident account maintained in India as an NRO account.
 - V. Ensure applicable income tax and other taxes in India are paid.

Which of the following is the correct sequence?

- (A) IV, V, II, I, III
- (B) IV, I, V, II, III
- (C) I, IV, V, II, III

(D) IV, V, I, II, III

May/June 2005

11. Identify the incorrect statement regarding foreign currency accounts maintained by a bank with another bank.

(A) VOSTRO account means “Their account with them” and is strictly maintained in a third-party currency.
 (B) SBI Mumbai maintaining a USD account with CITI Bank, New York is a NOSTRO account in the books of SBI, Mumbai.
 (C) LORO is an Italian word which means ‘Their’, representing a ‘Third Party Account’.
 (D) A mirror account is a reflection or a shadow of the NOSTRO account, maintained in two currencies.

Oct/Nov 2022

12. Identify the incorrect statement regarding the operational features of FCNR (B) accounts.

(A) Deposits are accepted in foreign currency and repaid in the same currency with interest.
 (B) Joint accounts can be opened by an NRI with a resident relative on a ‘former or survivor’ basis.
 (C) The resident relative joint holder can operate the account freely without a Power of Attorney.
 (D) The permitted credit is applicable only for opening the account since it is a fixed term deposit.

May/June 2018

13. American Express Bank, New York maintains a Rupee Account with SBI, Mumbai. When Citi Bank refers to this specific Rupee account maintained by American Express Bank with SBI, what term will Citi Bank use?

(A) NOSTRO Account
 (B) LORO Account
 (C) VOSTRO Account
 (D) Mirror Account

Oct/Nov 2016

14. An NRI opens an FCNR (B) floating rate deposit account with a maturity of three years. According to Reserve Bank of India instructions, what is the mandatory interest reset period for this deposit?
 (A) Monthly

(B) Quarterly
 (C) Six months
 (D) Annually

May/June 2014

15. What is the approximate annual volume of financial messages carried by SWIFT?

(A) Over 1 billion
 (B) Over 3 billion
 (C) Over 11 billion
 (D) Over 5 billion

Oct/Nov 2007

16. Identify the correct statement regarding the tax implications and utilization restrictions on Resident Foreign Currency (RFC) accounts.

(A) Interest earned on RFC balances is subject to a flat 10% tax deduction at source in India.
 (B) Balances are subject to strict utilization restrictions for the first two years after arrival.
 (C) The returning NRI is considered a full Resident for taxation on RFC interest from the day of arrival.
 (D) Interest is tax-exempt and balances are repatriable if the holder reverts to NRI status.

May/June 2025

17. Match the items in List I with those in List II.
 List I: (Electronic modes of transmission/payment gateways)

P. CHIPS
 Q. Fedwire
 R. CHAPS
 S. TARGET2

List II: (Defining features)

1. A payment system operating on gross settlement basis, handling interbank transfers out of New York and domestic commercial payments across the USA.
2. A Euro payment system whose use is mandatory for the settlement of any euro operations involving the Eurosystem.
3. A clearing system established by the New York Clearing House, operating as a net settlement payment system mainly for foreign exchange and Euro Dollar settlements.
4. A British equivalent to CHIPS, handling receipts and payments in London using a net payment settlement system.

- (A) P-2, Q-3, R-1, S-4
- (B) P-3, Q-1, R-4, S-2
- (C) P-1, Q-4, R-2, S-3
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2019

18. What is the primary prerequisite for a person resident outside India to open a Special Non-Resident Rupee Account (SNRR)?
- (A) Holding a valid tourist visa for a period exceeding six months for personal travel.
 - (B) Intending to purchase agricultural or plantation property in India for investment.
 - (C) Having a business interest in India for bona fide rupee transactions.
 - (D) Desiring to earn tax-free interest on rupee deposits within a designated account.

May/June 2009

19. Identify the correct pair regarding the identifiers used in international payment systems.
- (A) ABA numbers – Identifies the senders and receivers of payments in Fedwire
 - (B) CHIP participant codes – Identifies the beneficiary account
 - (C) UID numbers – Identifies the participating banks in CHIPS
 - (D) Swift BIC – Identifies the net position of an account with the Federal Reserve

Oct/Nov 2011

20. Consider the following statements regarding the operations in an SNRR account:
- I. The operations should not result in the account holder making available foreign exchange to any person resident in India against reimbursement in rupees.
 - II. An SNRR account may be designated as a resident rupee account upon the account holder becoming a resident.
- Which of the above statement(s) is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

May/June 2010

21. Identify the incorrect statement regarding the Euro clearing systems and their features.
- (A) TARGET2 – Its use is mandatory for new members joining the Eurozone.
 - (B) RTGSplus – A German hybrid clearing

system operating as a European-oriented real-time gross settlement system.

- (C) STEP 2 – A Pan-European Automated Clearing House (PE-ACH) facilitating straight-through processing for retail payments in euro.
- (D) EBA-EURO 1 – A gross settlement system with focus on retail Euro payments exclusively.

Oct/Nov 2024

22. Identify the incorrect pair regarding the investment avenues for NRIs and their repatriation status.
- (A) Units of UTI / Mutual funds – Repatriable as well as non-repatriable basis
 - (B) Shares in Public Sector Enterprises being disinvested – Repatriation basis
 - (C) Company fixed deposits – Repatriable basis only
 - (D) National Plan/Savings Certificates – Non-repatriation basis

May/June 2017

23. Consider the following statements regarding RTGS and NEFT in India:
- I. RTGS is managed by IDBRT, Hyderabad, which connects all banks to a central server maintained at RBI.
 - II. The minimum amount for RTGS transfers for customer remittances is Rs. 2.00 lakhs with no upper ceiling.
 - III. NEFT operates on a real-time gross settlement basis for large remittances.
 - IV. RTGS is available for customers 24/7/365 days w.e.f. December 14th, 2020.
 - V. The beneficiary bank must credit the account within 30 minutes of receiving the RTGS funds transfer message.

Which of the above statements are correct?

- (A) Only I, II, III, and IV
- (B) Only I, II, IV, and V
- (C) Only II, III, IV, and V
- (D) All I, II, III, IV, and V

Oct/Nov 2005

24. NRIs are granted general permission to purchase equity shares or convertible debentures of an Indian company. In relation to the procedural aspects like submission of reports and CA certificates, what is the NRI's obligation?
- (A) The NRI is not required to undertake any

procedural aspect.

- (B) The NRI must submit quarterly returns to the RBI regarding all share holdings.
- (C) The NRI is solely responsible for ensuring all CA certificates are filed with SEBI.
- (D) The NRI must register as a foreign portfolio investor prior to any market transaction.

May/June 2020

25. NEFT transactions initiated after normal banking hours are expected to be processed automatically. What operational mode facilitates this automation?
- (A) Straight Through Processing (STP)
 - (B) Bilateral Key Exchange (BKE)
 - (C) Pan-European Automated Clearing House (PE-ACH)
 - (D) Real-Time Gross Settlement Express Transfer

Oct/Nov 2015

26. An NRI sells shares of an Indian company on the stock exchange. The shares were originally purchased on a non-repatriable basis. Where must the sale proceeds of this transaction be credited?
- (A) Non-Resident (External) Rupee Account (NRE)
 - (B) Non-Resident Ordinary Rupee Account (NRO)
 - (C) Foreign Currency (Non-Resident) Account (Banks) [FCNR (B)]
 - (D) Special Non-Resident Rupee Account (SNRR)

May/June 2013

27. Section 6 of the Income Tax Act 1961 defines a Non-Resident Indian primarily based on:
- (A) The number of days a person stays outside India.
 - (B) The citizenship status held by the individual's grandparents.
 - (C) The amount of foreign exchange remitted to India in the preceding financial year.
 - (D) The nature of employment undertaken by the individual abroad.

Oct/Nov 2021

28. Identify the correct statement regarding an NRI's investment in a partnership firm or proprietorship concern in India.
- (A) The firm can freely engage in agricultural or

plantation activities for profit.

- (B) The firm can engage in real estate business with a view to earning capital gains.
- (C) Contribution must be by inward remittances or from NRE/FCNRB accounts.
- (D) The amount invested is strictly non-repatriable under all circumstances and rules.

May/June 2024

29. An Indian citizen stayed in India for 130 days during the financial year 2020-21. Prior to this, they stayed in India for 380 days across the preceding 4 financial years. Their taxable income in India for the year exceeds Rs. 15 lakhs. Based on the amendments effective from 1st April 2020, what will be their tax status?
- (A) Non-Resident Indian
 - (B) Resident
 - (C) Resident but Not Ordinarily Resident (RNOR)
 - (D) Deemed Resident without RNOR benefits

Oct/Nov 2008

30. Consider the following statements regarding the repatriation of sale proceeds of immovable property by an NRI:
- I. The sale proceeds required to be repatriated cannot exceed the foreign exchange brought in to acquire the property.
 - II. In the case of residential property, the repatriation of sale proceeds is restricted to not more than two properties.
- Which of the above statement(s) is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

May/June 2006

31. Consider the following statements regarding a 'Deemed Resident' for the purposes of Income Tax:
- I. It applies to an NRI who is not a tax resident of any country.
 - II. It requires the individual to have more than Rs. 15 lacs income in India earned from Indian Sources.
 - III. The status of deemed residency is applicable to NRIs who hold Indian Citizenship.
 - IV. The status of deemed residency is also applicable to Persons of Indian Origin

(PIOs).

Which of the above statements are correct?

- (A) Only I, II, and III
- (B) Only II, III, and IV
- (C) Only I, III, and IV
- (D) All I, II, III, and IV

Oct/Nov 2017

32. Citizens of specific countries, irrespective of their residential status, cannot acquire or transfer immovable property in India without prior permission of the Reserve Bank (other than a lease not exceeding five years). Which of the following sets of countries is entirely included in this restricted list?
- (A) United States of America, United Kingdom, Canada, and Australia.
 - (B) Japan, Germany, France, Italy, and other G7 member countries.
 - (C) Singapore, Malaysia, UAE, Saudi Arabia, and Kuwait.
 - (D) Pakistan, Bangladesh, Sri Lanka, and Afghanistan.

May/June 2008

33. A Person of Indian Origin (PIO) is a citizen of any other country who satisfies specific conditions. Which of the following conditions is an EXCEPTION (i.e., does NOT qualify them as a PIO under the stated rules)?
- (A) They were a citizen of India by virtue of the Constitution of India.
 - (B) They are a citizen of Pakistan or Bangladesh whose grandparents were born in India.
 - (C) They belonged to a territory that became part of India after the 15th day of August, 1947.
 - (D) They are a spouse of foreign origin of a citizen of India.

Oct/Nov 2013

34. Match the items in List I with those in List II.
- List I: (Investment instruments)
- P. Bonds issued by a PSU in India
 - Q. Units of Money Market Mutual Funds in India
 - R. Shares in Public Sector Enterprises being disinvested
 - S. National Plan/Savings Certificates
- List II: (Permissible investment basis)
- 1. Can be purchased without limit on repatriation basis

NODIA

- 2. Can be purchased without limit on non-repatriation basis
 - 3. Can be purchased without limit on repatriation basis
 - 4. Can be purchased without limit on non-repatriation basis
- (A) P-2, Q-1, R-4, S-3
 - (B) P-3, Q-4, R-1, S-2
 - (C) P-1, Q-2, R-3, S-4
 - (D) P-4, Q-3, R-2, S-1

May/June 2015

35. Identify the incorrect statement regarding the types of accounts that NRIs can open in India.
- (A) Special Non-Resident Rupee Account (SNRR) is maintained in designated foreign currencies.
 - (B) Non-Resident (External) Rupee Account (NRE) is maintained in Indian rupees.
 - (C) Non-Resident Ordinary Rupee Account (NRO) is maintained in Indian rupees.
 - (D) Foreign Currency (Non-Resident) Account (Banks) [FCNR (B)] can be maintained in foreign currencies.

Oct/Nov 2012

36. Consider the following statements regarding loans granted against NRI deposits:
- I. For loans sanctioned to a third party, there should be no direct or indirect foreign exchange consideration for the depositor.
 - II. Loans sanctioned to the account holder can be repaid by adjusting the deposits.
 - III. Premature withdrawal of deposits is freely available even where loans against such deposits are availed of.
 - IV. The term "loan" includes all types of fund-based/non-fund based facilities.
 - V. Loans outside India cannot be extended against balances held in NRO accounts.

Which of the above statements are correct?

- (A) Only I, II, IV, and V
- (B) Only I, III, IV, and V
- (C) Only II, III, IV, and V
- (D) All I, II, III, IV, and V

Oct/Nov 2020

37. Consider the following statements regarding permissible credits to an NRE account:
- I. Current income like rent, dividend, and pension can be credited provided the Authorised Dealer is satisfied that income

tax thereon has been deducted/paid.

- II. Maturity proceeds of investments can be credited only if such investments were made from the NRE account or through inward remittance.

Which of the above statement(s) is/are correct?

- (A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

May/June 2022

38. Identify the incorrect statement regarding Housing Loans granted to Non-Resident Indians for the acquisition of residential accommodation in India.

- (A) The quantum of loan, margin money, and period of repayment shall be the same as applicable for resident Indians.
(B) The loan shall be fully secured by equitable mortgage of the property proposed to be acquired.
(C) The loan amount shall be credited directly to the borrower's NRE or FCNR (B) account.
(D) Repayment can be made by rental income derived from renting out the acquired property.

Oct/Nov 2023

39. Mr. X, a resident Indian, holds a Power of Attorney for the NRE account of his brother who lives in Dubai. Mr. X wishes to transfer Rs. 1 lakh from this NRE account as a gift to his own daughter in India. Is this transaction permissible?

- (A) Yes, because a Power of Attorney holder has full unrestricted operational rights for local use.
(B) No, as the Power of Attorney holder cannot make gifts to residents for the account holder.
(C) Yes, provided the gift amount does not exceed the standard annual limit of Rs. 50,000 per year.
(D) No, because funds from an NRE account cannot be used for local disbursements to any third party.

Oct/Nov 2025

40. Which of the following activities is identified as a strictly prohibited transaction for Non-Resident Indians (NRIs)?

- (A) Trading in Transferable Development Rights (TDRs).
(B) Investing in units of UTI on a non-repatriable basis.
(C) Investing in company fixed deposits on a non-repatriable basis.
(D) Opening an NRO account for depositing domestic rent.

May/June 2012

41. An NRI maintains an NRE saving account and has utilized a temporary overdrawing facility of Rs. 40,000 to cover a local payment. According to the regulations, what is the maximum time frame within which this overdraft must be cleared?

- (A) Within one week by depositing local cash into the account by the holder.
(B) Within two weeks by remittance from abroad or from another NRE/FCNR account.
(C) Within one month through a transfer from a local NRO account held in India.
(D) Within six months by liquidating an existing mutual fund investment held in India.

May/June 2016

42. The term Correspondent Bank refers to a Financial Institution which provides services across the globe to the Banks who have a presence in the host countries. In this context, what is the bank in the home country, for which the correspondent bank acts as its agent, known as?

- (A) Nostro Bank
(B) Respondent Bank
(C) Loro Bank
(D) Intermediary Bank

May/June 2011

43. What is the fundamental purpose for which an NRO account is opened and maintained by a non-resident?

- (A) To facilitate non-repatriable credits from investments made prior to leaving the country.
(B) To safeguard all foreign currency deposits from the risk of sudden exchange rate fluctuations.
(C) To act as a transit account solely for the repatriation of unlimited foreign exchange out of India.
(D) To hold funds exclusively for trading in

Transferable Development Rights (TDRs) on a local basis.

Oct/Nov 2018

44. Read the following statements and select the correct option.

Assertion (A): The Financial Action Task Force (FATF)'s recommendation 13 requires additional measures to be applied to cross border correspondent banking relationships.

Reason (R): Cross border correspondent banking relationships are seen to be of inherently higher risk than domestic customer relationships.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

May/June 2023

45. Regarding the features of an NRO account, which of the following statements is an EXCEPTION (i.e., incorrect)?

- (A) It can be opened as Savings, Current, Recurring Deposit, or standard Term-Deposit account.
 (B) Joint accounts with residents are permitted only on 'former or survivor' basis.
 (C) All interest earned on NRO accounts is subject to the deduction of Income Tax at source.
 (D) All inward remittances from outside India are considered strictly permissible credits.

Oct/Nov 2009

46. Match the items in List I with those in List II.

List I: (Functions of Correspondent Banks)

- P. Clearing House functions
 Q. Collections
 R. Payments
 S. Investment services

List II: (Descriptions)

1. Providing statements of accounts, handling inward/outward payments, and intra-day credit
 2. Acting as agents for export/import documents and using Cash Letters or Lock boxes
 3. Executing instructions for settlement of FX

- deals or customer payments for imports
 4. Deploying overnight surplus balances at domestic call rates minus a small margin

- (A) P-2, Q-3, R-1, S-4
 (B) P-3, Q-1, R-4, S-2
 (C) P-1, Q-2, R-3, S-4
 (D) P-4, Q-2, R-3, S-1

May/June 2007

47. Consider the following statements regarding repatriation from an NRO account:

- I. Balances can be repatriated up to USD 1 million in a Financial Year.
 II. Repatriation is subject to conditions specified in Foreign Exchange Management (Remittance of Assets) Regulations, 2016.
 III. Transfers from NRO to NRE account within the overall limit do not require income tax clearance.

Which of the above statements are correct?

- (A) Only I and II
 (B) Only II and III
 (C) Only I and III
 (D) All I, II, and III

Oct/Nov 2014

48. Consider the following statements regarding the 'Other Services' offered by correspondent banks:

- I. These services typically require a mandatory account relationship with the correspondent bank.
 II. Services include LC confirmation, Letter of Credit advising, and arranging buyer's credit.
 III. These services can be offered based upon the relationship and credit assessment by the correspondent bank.

Which of the above statements are correct?

- (A) Only I and II
 (B) Only II and III
 (C) Only I and III
 (D) All I, II, and III

May/June 2019

49. Read the following statements and select the correct option.

Assertion (A): When a resident of India becomes a non-resident Indian, his existing resident account should be immediately converted into an NRO account.

Reason (R): An NRO account is basically designed to facilitate credits which accrue in

India on a non-repatriable basis, representing legitimate dues of the individual.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2006

50. A NOSTRO account is defined as:

- (A) A non-resident bank maintaining an account in the home country in the currency of the home country.
- (B) An account maintained by a bank to reflect the shadow entries of its transactions in a third-party bank.
- (C) A foreign currency account maintained by a bank in the home country with the bank in the host country.
- (D) An account belonging to other banks, representing a third-party account in the books of the host bank.

May/June 2021

51. Foreign currency (non-resident) Account (Banks) [FCNR (B)] are:

- (A) Term Deposits with a minimum period of one year, maintained in foreign currency.
- (B) Foreign currency accounts that can be opened as Savings, Current, or Term Deposits.
- (C) Rupee accounts that offer complete protection against the risk of exchange fluctuations.
- (D) Accounts specifically meant for foreign tourists visiting India for periods less than six months.

Oct/Nov 2010

52. Consider the following statements regarding Mirror accounts:

- I. The entries in the mirror account are used for the reconciliation of entries in the NOSTRO account.
- II. The mirror account is maintained solely in the foreign currency to avoid exchange rate discrepancies.

Which of the above statement(s) is/are correct?

- (A) Only I

- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2005

53. Consider the following statements regarding the 'Other Facilities' available in FCNR (B) accounts:

- I. There is no exchange risk for the account holder as the account is maintained in foreign currency.
- II. Interest on the deposit is compounded at quarterly intervals of 90 days.
- III. Income earned by way of interest is exempted from income tax.
- IV. Forward Cover can be booked to hedge the balance held in the account.

Which of the above statements are correct?

- (A) Only I, II, and III
- (B) Only I, III, and IV
- (C) Only II, III, and IV
- (D) All I, II, III, and IV

Oct/Nov 2022

54. Consider the following statements regarding SWIFT:

- I. It is a cooperative society owned by member banks and financial institutions.
- II. It operates on an automatic authentication of financial messages through bilateral key exchange (BKE).
- III. It is driven and defined by its vision, mission, and three core values: Excellence, Community, and Innovation.
- IV. It utilizes a Relationship Management Application (RMA) for authentication key exchange between banks.

Which of the above statements are correct?

- (A) Only I, II, and III
- (B) Only II, III, and IV
- (C) Only I, III, and IV
- (D) All I, II, III, IV, and V

May/June 2018

55. An NRI returns to India for permanent settlement and subsequently receives superannuation benefits from their erstwhile employer abroad in foreign currency. Which account is most appropriate to receive and hold these funds without limits on future repatriation?

- (A) Non-Resident Ordinary (NRO) Account
- (B) Resident Foreign Currency (RFC) Account

- (C) Special Non-Resident Rupee (SNRR) Account
(D) Foreign Currency (Non-Resident) Account [FCNR (B)]

Oct/Nov 2016

56. Read the following statements and select the correct option.

Assertion (A): SWIFT provides a fast, reliable, and secure support for businesses worldwide by ensuring messages between banks are strictly authenticated.

Reason (R): Banks are required to have an authentication key exchanged between themselves through a set format by the use of Relationship Management Application (RMA).

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2014

57. Mr. A, who went abroad in 2010, returned to India on 2nd Dec 2021 for permanent settlement. He holds an NRE Fixed Deposit of Rs. 72 lacs that will mature on 31st Dec 2021. What is the permissible course of action for these funds upon maturity?

- (A) He may convert the FDs on maturity into an RFC account fully or partially.
(B) The funds must be compulsorily converted into an NRO account upon maturity in India.
(C) The funds must be repatriated abroad immediately upon maturity to avoid local taxation.
(D) The funds must be forfeited to the Reserve Bank of India as the holder is now a resident.

Oct/Nov 2007

58. Arrange the following payment gateways/systems in the chronological order of their inception or specific operational milestones:
I. RTGS transfer availability 24/7/365 days
II. Fedwire operated by Federal Reserve Bank
III. NEFT additional half-hourly settlements introduced
IV. CHIPS major payment system operating in

the USA

Which of the following is the correct sequence?

- (A) II, IV, III, I
(B) I, III, II, IV
(C) IV, II, I, III
(D) II, III, IV, I

May/June 2025

59. Consider the following statements regarding the salient features of SNRR accounts:

- I. The account shall not earn any interest.
II. The tenure of the account should in no case exceed 7 years.
III. The balances in the SNRR account shall be eligible for repatriation.
IV. Transfers from any NRO account to the SNRR account are prohibited.
V. All transactions in the SNRR account will be exempt from applicable taxes in India.

Which of the above statements are correct?

- (A) Only I, II, III, and IV
(B) Only II, III, IV, and V
(C) Only I, III, IV, and V
(D) All I, II, III, IV, and V

Oct/Nov 2019

60. Which of the following is NOT a characteristic of the Fedwire system?

- (A) It handles a majority of domestic payments across all US states.
(B) It involves over 9,000 participants.
(C) It is an automated computer-based messaging and payment system working on a net settlement basis.
(D) It handles local borrowings and lending, commercial payments, and securities transaction related payments.

May/June 2009

61. Authorised Dealer banks are permitted to issue International Credit Cards to NRIs/PIOs. Such transactions may be settled by inward remittance or out of balances held in specific accounts. Which of the following accounts is NOT permitted for settling these credit card dues?

- (A) Foreign Currency (Non-Resident) Account [FCNR (B)]
(B) Special Non-Resident Rupee Account (SNRR)
(C) Non-Resident (External) Rupee Account (NRE)

(D) Non-Resident Ordinary Rupee Account (NRO)

Oct/Nov 2011

62. An American bank needs to execute an interbank transfer to settle a local commercial borrowing in California. Simultaneously, it needs to send a payment to a London-based bank using the British equivalent of CHIPS. Which combination of systems will the bank utilize for these two transactions respectively?
- (A) Fedwire and TARGET2
(B) CHIPS and STEP 1
(C) Fedwire and CHAPS
(D) CHIPS and RTGSplus

May/June 2010

63. The amount due or payable to a non-resident nominee from the account of a deceased account holder is processed in a specific manner. What is the most appropriate action taken by the authorised bank in India in this situation?
- (A) The amount is immediately remitted abroad via SWIFT without any local tax deduction.
(B) The amount is credited to the NRE account of the nominee for future repatriation.
(C) The amount is held in a special suspense account until the nominee physically visits India.
(D) The amount is credited to the nominee's NRO account with an authorised bank.

Oct/Nov 2024

64. What is the minimum amount stipulated for a customer remittance through the RTGS system?
- (A) Rs. 1.00 lakh
(B) Rs. 2.00 lakhs
(C) Rs. 5.00 lakhs
(D) There is no minimum amount

May/June 2017

65. Consider the following statements regarding the Portfolio Investment Scheme for NRIs/PIOs:
- I. An NRI or a PIO can purchase shares up to 5% of the paid-up capital of an Indian company.
II. All NRIs/PIOs taken together cannot purchase more than 10% of the paid-up capital of the company.
III. Sale and purchase transactions can be routed directly through any stockbroker without involving a designated bank branch.

Which of the above statements are correct?

- (A) Only I and II
(B) Only II and III
(C) Only I and III
(D) All I, II, and III

Oct/Nov 2005

66. Read the following statements and select the correct option.
- Assertion (A): The implementation of RTGS and NEFT has led to a great reduction in remittances and payments sent earlier through cheques and drafts.
Reason (R): Both RTGS and NEFT have facilitated faster funds transfer for bank customers across the country.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

67. Match the items in List I with those in List II.
- List I: (Investment Avenues for NRIs)
P. Units of UTI
Q. Company fixed deposits
R. Partnership firm concern
S. Immovable Property
- List II: (Regulatory conditions)
1. Can be acquired by way of inheritance from a person resident outside India.
2. Permitted on non-repatriable basis only, credited to NRO on maturity.
3. Permitted on repatriable as well as non-repatriable basis.
4. Capital contribution must not be for agricultural/plantation activity or real estate business.
- (A) P-3, Q-2, R-4, S-1
(B) P-2, Q-3, R-1, S-4
(C) P-4, Q-1, R-3, S-2
(D) P-1, Q-4, R-2, S-3

Oct/Nov 2015

68. Consider the following statements regarding the definition of a 'Resident' under the Income Tax Act 1961:
- I. An individual is a resident if they are in

India for at least 182 days in the preceding Financial Year.

- II. An individual is a resident if they are in India for at least 365 days in the last 4 Financial Years and at least 60 days in the preceding Financial Year.
- III. The status applies exclusively to individuals holding an Indian passport.
- Which of the above statements are correct?

- (A) Only I and II
(B) Only II and III
(C) Only I and III
(D) All I, II, and III

May/June 2013

69. An NRI wishes to acquire property in India using funds from his NRE account. Under FEMA guidelines, which type of property is he NOT permitted to acquire?
- (A) A commercial office space in Mumbai
(B) A residential flat in Delhi
(C) A retail shop in Chennai
(D) A farm house in Punjab

Oct/Nov 2021

70. Identify the correct statement regarding the status of 'Resident but Not Ordinarily Resident' (RNOR) for the purposes of Income Tax.
- (A) An individual must have stayed in India for more than 730 days in the last 7 Financial Years to be an RNOR.
(B) A deemed resident earning less than Rs. 15 lacs from Indian sources is classified as RNOR.
(C) An individual must have stayed outside India for 9 years out of the last 10 preceding Financial Years.
(D) A PIO earning more than Rs. 15 lacs from Indian sources must stay in India for at least 182 days in the previous FY to be an RNOR.

May/June 2024

71. Consider the following statements regarding the repatriation of funds out of balances held in NRO accounts representing the sale proceeds of immovable property:
- I. Banks can permit repatriation up to USD 1 million per financial year.
II. If the property was acquired while a resident, the 1 million USD limit applies to the sale proceeds.
III. The property must have been acquired in

accordance with the foreign exchange laws in force at the time of acquisition.

- IV. Repatriation is subject to the payment of applicable taxes.

Which of the above statements are correct?

- (A) Only I, II, and III
(B) Only I, III, and IV
(C) Only II, III, and IV
(D) All I, II, III, and IV

Oct/Nov 2008

72. According to FEMA 1999, which of the following perfectly fits the definition of a Non-Resident Indian?
- (A) A person resident outside India who is a citizen of India.
(B) A foreign citizen visiting India on a tourist visa for less than 182 days.
(C) An individual residing in India who intends to establish a business abroad.
(D) An official of a foreign multinational corporation deputed to India for a definite period.

May/June 2006

73. A foreign national of French origin (not included in the restricted 11 countries) is currently a resident in India. They wish to acquire a residential flat in India. Are they permitted to do so under the regulations?
- (A) Yes, foreign nationals resident in India can acquire immovable property.
(B) No, foreign nationals of non-Indian origin are completely banned from acquiring property.
(C) Yes, but only if they form a partnership firm with a resident Indian citizen in India.
(D) No, they can only lease property for a period not exceeding 3 years for residential use.

Oct/Nov 2017

74. An entity operating as an Overseas Corporate Body (OCB), predominantly owned by non-resident Indians (80% ownership), approaches an Authorised Dealer bank to make a fresh investment in an Indian company. Based on the regulations effective 16.09.2003, what action must the bank take?
- (A) Allow the fresh investment as the NRI ownership percentage exceeds the threshold of 60%.
(B) Reject the investment as OCBs are no longer

recognized as an eligible investor class.

- (C) Allow the investment provided that the funds are routed through a specific NRE account.
- (D) Allow the investment under the Portfolio Investment Scheme after obtaining local clearances.

May/June 2008

75. Consider the following statements regarding advances to non-residents against non-resident deposits:

- I. Loans can be granted in India to the account holder or a third party subject to usual norms.
- II. The loan amount can be freely used for carrying on agricultural/plantation activities.
- III. Authorised Dealers can sanction loans in India without any limit, subject to usual margin requirements.
- IV. These loans cannot be repatriated outside India.

Which of the above statements are correct?

- (A) Only I, II, and III
- (B) Only I, III, and IV
- (C) Only II, III, and IV
- (D) All I, II, III, and IV

Oct/Nov 2013

76. For opening any Non-Resident Account, the bank has to obtain an application in the prescribed form along with a specific undertaking. What is the nature of this undertaking?

- (A) To ensure the account holder shall not repatriate more than USD 1 million in a financial year.
- (B) To confirm that the account holder shall pay all applicable income taxes on global earnings.
- (C) To inform the bank of their arrival date upon returning for permanent settlement.
- (D) To ensure that the account holder will maintain a mirror account to reconcile transactions.

May/June 2015

77. An Authorised Dealer's branch in London is requested to grant a loan to a third party for a bona fide purpose against the security of funds held by an NRI in an Indian bank account. Against which of the following accounts is the

branch explicitly prohibited from extending this loan?

- (A) NRE Account
- (B) NRO Account
- (C) Foreign Currency (Non-Resident) Account (Banks) [FCNR (B)]
- (D) Resident Foreign Currency (RFC) Account

Oct/Nov 2012

78. Read the following statements and select the correct option.

Assertion (A): Joint NRE accounts can be opened by an NRI/PIO with a resident relative on a 'former or survivor' basis.

Reason (R): During the lifetime of the NRI/PIO account holder, the resident relative can operate the account only as a Power of Attorney holder.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2020

79. Consider the following statements regarding the repayment of housing loans granted to NRIs:

- I. Repayment can be made by remittance from abroad.
- II. Repayment can be made by debit to his NRE, FCNR (B), or NRO account.
- III. Repayment cannot be made using rental income derived from the property acquired.

Which of the above statements are correct?

- (A) Only I and II
- (B) Only II and III
- (C) Only I and III
- (D) All I, II, and III

May/June 2022

80. Consider the following statements regarding the facilities offered by NRE accounts:

- I. Full repatriation of deposit amount including interest is permitted.
- II. Income by way of interest on balances held is exempted from income tax.
- III. Nomination facility is permitted, but the nominee must be a resident.
- IV. The account provides protection against exchange fluctuation risk to the depositor.

NODIA

V. Banks may allow temporary overdrawing up to Rs. 50,000 in NRE saving account.

Which of the above statements are correct?

- (A) Only I, II, and V
- (B) Only I, II, III, and V
- (C) Only II, IV, and V
- (D) All I, II, III, IV, and V

ANSWERS

1. (B) He can operate the PPF account, but intra-day trading is prohibited.
Non-resident Indians who opened a Public Provident Fund account while residing in India are permitted to continue maintaining the account until its maturity on a non-repatriation basis. However, they are strictly prohibited from engaging in intra-day trading in the Indian stock market. They must instead operate through the Portfolio Investment Scheme for delivery-based transactions only to ensure regulatory compliance.
2. (C) Resident becoming a non-resident → Existing resident account immediately converted into an NRO account.
When an Indian resident moves abroad with the intention of staying for an indefinite period, their existing resident bank accounts must be re-designated as Non-Resident Ordinary accounts. This mandatory conversion ensures that local earnings and liabilities are managed under the appropriate regulatory framework for non-residents, facilitating the legitimate routing of domestic income like rent, dividends, or interest.
3. (A) The need to have a global network of branches
Correspondent banking establishes a relationship where one bank provides services on behalf of another in a different geographical location. This arrangement eliminates the fundamental requirement for the respondent bank to maintain a physical presence or an extensive network of branches in foreign countries. It allows banks to facilitate international transactions and trade finance efficiently using the correspondent's local expertise.
4. (D) P-3, Q-4, R-1, S-2
Foreign Currency Non-Resident (Banks) accounts are term deposits maintained in foreign currency. Non-Resident External accounts are rupee-based and fully repatriable. Special Non-Resident Rupee accounts support specific business interests for up to seven years. Non-Resident Ordinary accounts manage domestic earnings like rent and permit repatriation of up to one million USD per financial year after fulfilling all required tax obligations.
5. (D) Noting and protesting bills of exchange for the respondent bank
Clearing house functions provided by correspondent banks typically include managing inward and outward payments, providing intra-day credit lines, and handling reimbursements for letter of credit claims. However, noting and protesting bills of exchange is categorized under collection services rather than clearing house operations. These collection services involve the correspondent acting as an agent to handle specific legal financial documents.
6. (C) They may open the account with a valid visa and permit without prior RBI approval.
Individuals of Bangladesh nationality who hold a valid visa and a valid residential permit issued by the Foreigners Registration Office or Foreigners Regional Registration Office are permitted to open a Non-Resident Ordinary account. In such cases, prior approval from the Reserve Bank of India is not required, provided the individual is physically present in India for a legitimate purpose.
7. (B) The correspondent bank grants overdrafts for temporary overnight needs to fill up short-term funding gaps.
Correspondent banks provide overdraft facilities to respondent banks specifically to manage temporary overnight funding gaps or short-term liquidity mismatches. These facilities ensure the smooth processing of payment instructions and settlements even when there are timing differences in fund arrivals. Such arrangements require formal agreements and are usually tied to the existing account relationship maintained between the two banks.
8. (A) Only I, II, III, and IV
Non-Resident Ordinary accounts for foreign tourists can be funded via inward remittances or by selling foreign exchange brought into India. These accounts are temporary and must not

exceed a duration of six months. Upon departure, the remaining balances can be converted back to foreign currency for the traveler, provided the account was not credited with any prohibited local funds.

9. (A) Yes, as these 'Other Services' do not normally require an account relationship.

Correspondent banks offer various non-account-based services, such as providing credit reports on foreign parties and advising on letters of credit. These are classified as miscellaneous or other services. A bank can access these facilities even without maintaining a formal account relationship with the foreign correspondent. This enables banks to support their corporate clients in international trade efficiently.

10. (D) IV, V, I, II, III

To facilitate the collection of bona fide dues for a departing foreign national, the bank first re-designates the resident account as a Non-Resident Ordinary account. After ensuring all applicable taxes are paid, the account is debited specifically for repatriation purposes. Funds are then sent abroad within the annual limit of one million USD, followed by the immediate closure.

11. (A) VOSTRO account means "Their account with them" and is strictly maintained in a third-party currency.

A Vostro account is a domestic currency account maintained by a foreign bank with a bank in the host country, literally meaning your account with us. In contrast, a Nostro account is a foreign currency account held by a domestic bank with a foreign correspondent. While Nostro and Vostro are mirror images, the description of Vostro is often misunderstood.

12. (C) The resident relative joint holder can operate the account freely without a Power of Attorney. In Foreign Currency Non-Resident (Banks) accounts, joint holdings with resident relatives are permitted on a former or survivor basis. However, the resident joint holder is not allowed to operate the account freely as a full owner. Their operational powers are strictly limited to those of a Power of Attorney holder, primarily for making local payments and conducting legitimate domestic transactions.

13. (B) LORO Account

When a bank refers to a foreign currency or rupee account maintained by another bank with a third-party financial institution, it uses the term Loro account. Derived from Italian meaning theirs, this term distinguishes the account from the bank's own Nostro or Vostro relationships. It is a common designation in international banking to track external account balances and settlements.

14. (C) Six months

According to the guidelines issued by the Reserve Bank of India, floating rate deposits under the Foreign Currency Non-Resident (Banks) scheme must have a mandatory interest reset period of six months. This requirement ensures that the interest rates on these long-term deposits remain aligned with prevailing international market benchmarks while providing a structured framework for both banks and depositors.

15. (C) Over 11 billion

The Society for Worldwide Interbank Financial Telecommunication, commonly known as SWIFT, is the global leader in secure financial messaging. It connects thousands of financial institutions across more than two hundred countries. Due to its widespread adoption for international payments and settlements, the system processes a massive volume of financial messages, which currently exceeds eleven billion transactions annually.

16. (D) Interest is tax-exempt and balances are repatriable if the holder reverts to NRI status.

Resident Foreign Currency accounts are designed for returning non-residents to hold foreign assets. The interest earned on these accounts is generally tax-exempt for individuals who qualify as Resident but Not Ordinarily Resident. Furthermore, the funds maintained in these accounts remain fully repatriable without any restrictions if the account holder decides to move abroad again and reverts to non-resident status.

17. (B) P-3, Q-1, R-4, S-2

The Clearing House Interbank Payments System operates as a net settlement system primarily for foreign exchange in New York. Fedwire is a real-time gross settlement system for domestic US transfers. The Clearing House Automated Payment System serves as the British equivalent

for sterling payments. TARGET2 is the mandatory settlement system for euro-related operations involving the Eurosystem.

18. (C) Having a business interest in India for bona fide rupee transactions.

A Special Non-Resident Rupee account is specifically designed for persons resident outside India who have a bona fide business interest in the country. This account facilitates rupee-denominated transactions related to their business operations. Unlike standard savings accounts, it is a non-interest-bearing account with a restricted tenure, emphasizing its purpose as a vehicle for commercial and business-related financial activities.

19. (A) ABA numbers – Identifies the senders and receivers of payments in Fedwire

In the United States, the American Bankers Association routing numbers are essential identifiers used within the Fedwire system to recognize the specific senders and receivers of electronic payments. These nine-digit codes ensure that funds are directed accurately between financial institutions. Similarly, other systems like CHIPS use unique Participant Codes or Universal Identification numbers to facilitate the seamless processing.

20. (C) Both I and II

Operations in a Special Non-Resident Rupee account must ensure that the holder does not make foreign exchange available to residents against rupee reimbursement. This prevents unauthorized currency arbitrage. Additionally, if the account holder's residential status changes to resident, the SNRR account can be re-designated as a resident rupee account, aligning with the regulatory requirements for domestic banking operations.

21. (D) EBA-EURO 1 – A gross settlement system with focus on retail Euro payments exclusively. The Euro Banking Association operates the EURO 1 system, which is a private-sector large-value payment system for the euro. It functions on a multilateral net settlement basis rather than being a gross settlement system focused exclusively on retail payments. Other systems like STEP 2 handle retail transactions, while

TARGET2 remains the primary real-time gross settlement system for the Eurozone.

22. (C) Company fixed deposits – Repatriable basis only

Non-resident Indians are permitted to invest in company fixed deposits on both repatriable and non-repatriable bases, depending on the source of funds and the specific terms of the investment. Stating that these are only allowed on a repatriable basis is incorrect under current FEMA regulations. Most investment avenues, including mutual funds and shares, offer both options to depositors.

23. (B) Only I, II, IV, and V

Real-Time Gross Settlement is a high-value payment system with a minimum limit of two lakh rupees, operating continuously since late 2020. It is managed by the Reserve Bank of India and requires beneficiary banks to credit accounts within thirty minutes. Unlike NEFT, which settles in batches, RTGS processes transactions individually. These digital systems have significantly enhanced the speed and reliability of transfers.

24. (A) The NRI is not required to undertake any procedural aspect.

Under the general permission granted for purchasing equity shares or convertible debentures, Non-Resident Indians are not burdened with the procedural responsibilities of filing reports or Chartered Accountant certificates with the regulator. These compliance tasks, including the submission of various statutory returns and monitoring of investment limits, are typically handled by the Indian company or the designated Authorised Dealer bank.

25. (A) Straight Through Processing (STP)

To facilitate the automatic processing of National Electronic Funds Transfer transactions, especially outside of regular banking hours, banks utilize Straight Through Processing. This technology allows the entire payment instruction to be executed from initiation to final settlement without manual intervention. By eliminating human processing steps, STP increases efficiency, reduces errors, and ensures that remittances are delivered to accounts rapidly.

26. (B) Non-Resident Ordinary Rupee Account (NRO)

When a Non-Resident Indian sells shares that were originally acquired on a non-repatriation basis, the resulting sale proceeds must be credited to their Non-Resident Ordinary rupee account. These funds are considered domestic assets and are subject to the specific repatriation limits applicable to NRO balances. They cannot be credited to NRE or FCNR (B) accounts.

27. (A) The number of days a person stays outside India.

The Income Tax Act of 1961 determines the residential status of an individual primarily based on the duration of their physical presence in India during a financial year. Specifically, it counts the total number of days an individual stays within the country's borders. This quantitative measure is used to classify taxpayers as residents, non-residents, or residents but not ordinarily residents.

28. (C) Contribution must be by inward remittances or from NRE/FCNRB accounts.

Non-Resident Indians are permitted to invest in the capital of partnership firms or proprietorship concerns in India, provided the investment is made through inward remittances or from balances held in NRE or FCNR (B) accounts. However, such firms must not engage in prohibited activities like agricultural operations, plantation business, or real estate business, except for specific construction projects.

29. (C) Resident but Not Ordinarily Resident (RNOR)
Under the amended tax rules effective from April 2020, an Indian citizen who stays in India for 120 days or more but less than 182 days, and has a total income exceeding fifteen lakh rupees from Indian sources, is classified as a Resident but Not Ordinarily Resident. This status also applies to those who were non-residents in previous years.**30. (C) Both I and II**

When an NRI sells immovable property in India, the amount eligible for repatriation abroad is limited to the foreign exchange originally brought into the country to purchase that specific property. Furthermore, for residential properties, this repatriation facility is restricted to the sale proceeds of a maximum of two such properties,

ensuring compliance with long-term foreign exchange management guidelines.

31. (A) Only I, II, and III

The concept of a deemed resident applies to Indian citizens who are not liable to tax in any other country due to their domicile or residence. To qualify, their total income from Indian sources must exceed fifteen lakh rupees. This specific status is applicable only to citizens of India and does not extend to Persons of Indian Origin holding foreign citizenship.

32. (D) Pakistan, Bangladesh, Sri Lanka, and Afghanistan.

The Reserve Bank of India maintains a restricted list of countries whose citizens require prior permission to acquire or transfer immovable property in India, regardless of their residential status. This list includes neighboring nations such as Pakistan, Bangladesh, Sri Lanka, and Afghanistan. These individuals are generally only permitted to take property on short-term leases for residential purposes.

33. (B) They are a citizen of Pakistan or Bangladesh whose grandparents were born in India.

A Person of Indian Origin is generally defined as a foreign citizen who was once an Indian citizen or has ancestral links to India. However, the regulatory framework explicitly excludes citizens of certain countries from this definition for various financial and property transactions. Specifically, citizens of Pakistan and Bangladesh are not considered PIOs under these rules for banking purposes.

34. (C) P-1, Q-2, R-3, S-4

Non-Resident Indians can invest in various instruments with different repatriation rules. Bonds issued by Public Sector Undertakings and shares in Public Sector Enterprises undergoing disinvestment are typically allowed on a repatriation basis. Conversely, investments in Money Market Mutual Funds are typically repatriable, while National Savings Certificates are generally not available for fresh investment by NRIs and proceeds must be credited to local accounts.

- 35.** (A) Special Non-Resident Rupee Account (SNRR) is maintained in designated foreign currencies. Special Non-Resident Rupee accounts are specifically rupee-denominated accounts intended for bona fide business transactions in India. Stating that these accounts are maintained in designated foreign currencies is factually incorrect. In contrast, Non-Resident External and Non-Resident Ordinary accounts are also held in Indian rupees, while Foreign Currency Non-Resident (Banks) accounts are strictly maintained in various approved foreign currencies.
- 36.** (A) Only I, II, IV, and V
Banks can grant loans against non-resident deposits to the account holder or third parties, provided there is no foreign exchange consideration for the depositor. These loans can be repaid by adjusting the deposit balances. However, premature withdrawal of such deposits is not freely available if a loan is outstanding. Furthermore, NRO-based loans cannot be extended outside of India.
- 37.** (C) Both I and II
Permissible credits to a Non-Resident External account include current income such as rent, dividends, and pensions, provided the bank is satisfied that the relevant income taxes have been paid. Additionally, the maturity proceeds of investments can be credited if the original investment was funded through an NRE account or inward remittance. These rules ensure the integrity of the status.
- 38.** (C) The loan amount shall be credited directly to the borrower's NRE or FCNR (B) account.
When Authorised Dealers grant housing loans to Non-Resident Indians for acquiring residential property, the loan amount must not be credited directly to the borrower's NRE or FCNR (B) accounts. Instead, the funds are typically disbursed to the seller or to the borrower's NRO account. Repayment of these loans can be made through remittances from abroad or local income.
- 39.** (B) No, as the Power of Attorney holder cannot make gifts to residents for the account holder. Although a Power of Attorney holder for a Non-Resident External account is permitted to operate the account for local payments and investments, they are strictly prohibited from making gifts from the account. This restriction applies even if the recipient is a resident relative. Such transactions require the specific and direct instruction or execution by the account holder themselves.
- 40.** (A) Trading in Transferable Development Rights (TDRs).
Under the Foreign Exchange Management Act, certain activities are strictly prohibited for Non-Resident Indians to prevent speculative practices in the domestic market. One such prohibited activity is trading in Transferable Development Rights. While NRIs are allowed to invest in mutual funds, company deposits, and residential properties, they cannot engage in the business of buying and selling these certificates.
- 41.** (B) Within two weeks by remittance from abroad or from another NRE/FCNR account.
If an NRE savings account is temporarily overdrawn to facilitate a local payment, the regulations require that the overdraft must be cleared within a maximum period of two weeks. The account must be brought back into credit using funds received through inward remittances from abroad or via transfers from other NRE or FCNR (B) accounts held by the individual.
- 42.** (B) Respondent Bank
In a correspondent banking relationship, the financial institution located in the home country that utilizes the services of a foreign bank is known as the respondent bank. The foreign bank, acting as an agent in its own jurisdiction to facilitate international transactions and settlements, is referred to as the correspondent bank. This partnership allows the respondent bank to serve clients.
- 43.** (A) To facilitate non-repatriable credits from investments made prior to leaving the country.
The primary purpose of a Non-Resident Ordinary account is to provide a banking platform for individuals who have moved abroad to manage their financial assets in India. It is designed to hold and process non-repatriable credits, such as income from investments made while the individual was still a resident. This includes legitimate domestic earnings like rent, interest, or dividends.

44. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The Financial Action Task Force has established Recommendation 13 specifically for cross-border correspondent banking due to the elevated risks of money laundering and terrorist financing. These relationships are inherently riskier than domestic customer accounts because the respondent bank's customers are not directly known to the correspondent. Therefore, stringent due diligence and ongoing monitoring are mandatory for these partnerships.

45. (B) Joint accounts with residents are permitted only on 'former or survivor' basis.

Non-Resident Ordinary accounts offer flexibility in their operation, allowing for various account types such as savings, current, and term deposits. Unlike NRE accounts, joint NRO accounts with residents can be opened on any operational basis, including jointly or either or survivor. Stating that they are permitted only on a former or survivor basis is incorrect, as that applies elsewhere.

46. (C) P-1, Q-2, R-3, S-4

Correspondent banks perform several vital roles in global finance. Clearing house functions involve managing account statements and payment instructions. Collection services include acting as agents for trade documents. Payment services focus on executing settlements for foreign exchange and import transactions. Investment services allow respondent banks to earn interest on their overnight surplus balances by deploying them in money markets.

47. (A) Only I and II

Balances held in Non-Resident Ordinary accounts can be repatriated abroad up to a limit of one million US dollars per financial year. This process is governed by the Foreign Exchange Management (Remittance of Assets) Regulations of 2016. However, any transfer or repatriation from an NRO account, including transfers to an NRE account, requires proof of payment of all taxes.

48. (B) Only II and III

Correspondent banks offer a suite of services such as advising and confirming letters of credit and arranging buyer's credit for international trade.

These facilities are often extended based on the strength of the relationship and a thorough credit assessment of the respondent bank. Importantly, many of these other services can be accessed without the need for a formal account.

49. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

When an Indian resident changes their status to non-resident, their existing domestic bank accounts must be converted into Non-Resident Ordinary accounts. This is because NRO accounts are specifically designed to manage funds that accrue in India on a non-repatriable basis. This regulatory requirement ensures that the individual's legitimate domestic earnings, such as interest and rent, are handled appropriately.

50. (C) A foreign currency account maintained by a bank in the home country with the bank in the host country.

A Nostro account is a foreign currency account that a domestic bank maintains with a correspondent bank in another country. The term, derived from the Latin word for ours, represents our account with you in the books of the home bank. These accounts are essential for facilitating international trade, foreign exchange transactions, and global settlement processes between different financial systems.

51. (A) Term Deposits with a minimum period of one year, maintained in foreign currency.

Foreign Currency Non-Resident (Banks) accounts are term deposits that must be maintained for a minimum period of one year and a maximum of five years. These accounts are held in approved foreign currencies, such as US Dollars or Euros. They provide depositors with protection against exchange rate fluctuations, as both the principal and the interest are repaid in currency.

52. (A) Only I

A mirror account is an internal record maintained by a bank to reflect the transactions occurring in its Nostro account. It serves as a shadow account used primarily for the reconciliation of entries and tracking of funds. Unlike the actual Nostro account, the mirror account records entries in both the foreign currency and the local currency to facilitate accurate accounting.

53. (B) Only I, III, and IV

Foreign Currency Non-Resident (Banks) accounts offer several advantages, including the absence of exchange risk since the funds are held in foreign currency. The interest earned on these deposits is exempt from Indian income tax. Additionally, account holders have the option to book forward covers to hedge their balances. However, interest on these deposits is typically calculated at intervals.

54. (D) All I, II, III, IV, and V

SWIFT is a global member-owned cooperative that provides a secure platform for financial messaging. It operates using standardized message formats and ensures authenticity through a Relationship Management Application and bilateral key exchange. The organization is guided by core values of excellence, community, and innovation, which support its mission to deliver highly secure and reliable communication services globally.

55. (B) Resident Foreign Currency (RFC) Account

For a Non-Resident Indian returning to India for permanent settlement, the Resident Foreign Currency account is the most suitable option for holding foreign currency assets. This includes superannuation benefits or other monetary dues received from a former employer abroad. Balances in an RFC account can be freely used for international payments and are fully repatriable if needed.

56. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

SWIFT ensures the security and reliability of global business communications by requiring strict authentication for all messages sent between banks. This is achieved through the Relationship Management Application, which allows banks to exchange and manage authentication keys in a standardized format. By using these rigorous protocols, SWIFT maintains a high level of trust and prevents unauthorized transactions.

57. (A) He may convert the FDs on maturity into an RFC account fully or partially.

When an NRI returns to India for permanent settlement, their NRE fixed deposits can continue until maturity at the contracted rate of interest.

Upon maturity, the individual has the option to convert these funds into a Resident Foreign Currency account, either in full or in part. This allows the returning resident to maintain their savings in foreign currency assets.

58. (A) II, IV, III, I

The evolution of payment systems began with the establishment of Fedwire by the Federal Reserve Bank. This was followed by the development of the Clearing House Interbank Payments System in New York. In recent years, India's NEFT system introduced half-hourly settlement batches to increase frequency. Finally, the RTGS system was made available twenty-four hours a day in December 2020.

59. (A) Only I, II, III, and IV

Special Non-Resident Rupee accounts are non-interest-bearing and have a maximum tenure of seven years. These accounts are fully repatriable and are used for bona fide business transactions. To maintain their specific purpose, transfers from NRO accounts to SNRR accounts are strictly prohibited. While they offer operational convenience for business interests, all transactions remain subject to applicable taxes.

60. (C) It is an automated computer-based messaging and payment system working on a net settlement basis.

Fedwire is a real-time gross settlement system operated by the Federal Reserve Banks, facilitating the immediate transfer of funds between thousands of participants. It is used for various purposes, including commercial payments, securities transactions, and interbank lending across the United States. Unlike some other clearing systems, it does not function on a net settlement basis, ensuring immediate settlement.

61. (B) Special Non-Resident Rupee Account (SNRR)

Non-Resident Indians and Persons of Indian Origin can settle their international credit card dues using inward remittances or balances held in several types of accounts. Permitted accounts include the Non-Resident External, Non-Resident Ordinary, and Foreign Currency Non-Resident (Banks) accounts. However, the Special Non-Resident Rupee account is not authorized for this purpose as it is restricted.

62. (C) Fedwire and CHAPS

For executing a domestic interbank transfer to settle commercial borrowings within the United States, the Fedwire system is the standard choice. When the same bank needs to send a payment to a London-based institution using the British equivalent of the New York-based clearing system, it would utilize CHAPS. This combination reflects the primary high-value payment infrastructures in those jurisdictions.

63. (D) The amount is credited to the nominee's NRO account with an authorised bank.

When an account holder in India passes away, the amount due to a non-resident nominee is processed by the authorized bank according to specific guidelines. The funds are typically credited to the nominee's Non-Resident Ordinary account. This ensures that the proceeds from the deceased person's account are held within the appropriate regulatory framework while allowing for eventual repatriation.

64. (B) Rs. 2.00 lakhs

The Real-Time Gross Settlement system in India is designed for high-value fund transfers that require immediate processing. For customer-initiated remittances, the Reserve Bank of India has stipulated a minimum transaction amount of two lakh rupees. There is no upper ceiling on the amount that can be transferred, making it an ideal platform for large commercial and personal payments.

65. (A) Only I and II

Under the Portfolio Investment Scheme, a Non-Resident Indian can purchase up to five percent of the paid-up capital of an Indian company. Collectively, all NRIs are limited to a ten percent holding in a single company. Importantly, all such purchase and sale transactions must be routed through a designated bank branch to ensure proper monitoring and regulatory compliance.

66. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The introduction and expansion of RTGS and NEFT systems have significantly transformed the landscape of financial transactions in India. By providing a faster and more efficient way to transfer funds digitally, these systems have greatly reduced the reliance on traditional paper-

based instruments like cheques and demand drafts. Customers now prefer electronic modes due to their speed and security.

67. (A) P-3, Q-2, R-4, S-1

Non-Resident Indians have diverse investment options in India with varying rules. Units of UTI can be purchased on both repatriable and non-repatriable bases. Company fixed deposits are often restricted to a non-repatriation basis with proceeds going to NRO accounts. Partnership investments are allowed if they avoid prohibited sectors. Finally, immovable property can be legitimately acquired through inheritance from non-residents.

68. (A) Only I and II

According to the Income Tax Act of 1961, an individual is classified as a resident if they spend at least 182 days in India during the financial year. Alternatively, residency is established if they are in India for sixty days in the current year and have completed 365 days over the preceding four years. Residency is determined by stay.

69. (D) A farm house in Punjab

Non-Resident Indians are generally permitted to acquire residential and commercial properties in India using funds from their NRE or FCNR (B) accounts. However, the Foreign Exchange Management Act strictly prohibits them from purchasing certain types of land. This includes agricultural land, plantation property, and farmhouses. These restrictions are in place to regulate foreign investment in sensitive sectors.

70. (C) An individual must have stayed outside India for 9 years out of the last 10 preceding Financial Years.

The status of Resident but Not Ordinarily Resident is a specific tax classification in India. An individual qualifies for this status if they have been a non-resident in nine out of the ten financial years preceding the current year. This classification often provides certain tax exemptions on foreign income for a limited period for those who have recently returned.

71. (B) Only I, III, and IV

For the repatriation of sale proceeds of immovable property held in an NRO account, banks can permit transfers up to one million US dollars per financial year. This is contingent on the property

being acquired according to the laws in force at that time. Additionally, all applicable taxes must be paid before the funds are sent abroad.

- 72.** (A) A person resident outside India who is a citizen of India.

Under the Foreign Exchange Management Act of 1999, a Non-Resident Indian is defined specifically as an individual who is a citizen of India but is residing outside the country. This definition is crucial for determining the eligibility of individuals to open various types of bank accounts, make investments in Indian markets, and acquire property within the national territory.

- 73.** (A) Yes, foreign nationals resident in India can acquire immovable property.

A foreign national of non-Indian origin who is currently a resident of India is generally permitted to acquire immovable property in the country. This is allowed provided they do not belong to one of the specifically restricted nations listed by the regulator. Such individuals can buy residential or commercial property to support their life and business activities during residency.

- 74.** (B) Reject the investment as OCBs are no longer recognized as an eligible investor class.

Since September 2003, Overseas Corporate Bodies have been derecognized as an eligible class of investors in India. This move was taken by the Reserve Bank of India to prevent the misuse of investment routes. Consequently, any fresh investment proposal from an entity formerly classified as an OCB must be rejected by the bank, regardless of the underlying ownership.

- 75.** (B) Only I, III, and IV

Banks in India are permitted to grant loans against non-resident deposits to the account holder or third parties for bona fide purposes. These loans must adhere to standard margin requirements and cannot be used for prohibited activities like agricultural or plantation work. Importantly, these loan amounts are meant for use within India and cannot be repatriated outside.

- 76.** (C) To inform the bank of their arrival date upon returning for permanent settlement.

When opening a non-resident account, banks require the applicant to provide a specific undertaking. The account holder must agree

to inform the bank immediately upon their return to India for permanent settlement. This notification is essential for the bank to re-designate the account as a resident account, ensuring continued compliance with foreign exchange management regulations and taxation.

- 77.** (B) NRO Account

Authorised Dealer branches operating abroad are prohibited from extending loans to third parties against the security of funds held in a Non-Resident Ordinary account in India. While NRE and FCNR (B) accounts may sometimes be used as collateral for international lending under specific conditions, the NRO account remains strictly restricted due to its non-repatriable nature and domestic settlement.

- 78.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Non-Resident External accounts can be held jointly with a resident relative on a former or survivor basis. This arrangement ensures that the primary ownership remains with the non-resident. During the NRI's lifetime, the resident relative's ability to operate the account is legally restricted to the powers granted under a Power of Attorney, primarily for making local payments.

- 79.** (A) Only I and II

Non-Resident Indians can repay their housing loans in India through several authorized channels. These include sending remittances from abroad or debiting their NRE, FCNR (B), or NRO accounts. Furthermore, the regulations specifically allow the use of rental income derived from the property itself to service the loan, providing a convenient way for investors to manage their domestic liabilities.

- 80.** (A) Only I, II, and V

Non-Resident External accounts provide full repatriation of both the principal deposit and the interest earned. The interest income is exempt from tax in India. Banks are also permitted to allow a temporary overdraft of up to fifty thousand rupees in NRE savings accounts. However, unlike FCNR (B) accounts, NRE accounts do not protect the depositor against exchange fluctuations.

CHAPTER 04

Documentary Letters of Credit

Oct/Nov 2014

1. An Indian exporter enters into a sales contract with a buyer in Dubai. The terms agreed are “CIP Dubai”. The exporter delivers the goods to the first carrier and pays the carriage costs to Dubai. The exporter also procures insurance against the buyer’s risk of loss or damage during the carriage. Under Incoterms 2020, what is the default insurance coverage requirement for the CIP term that the exporter must fulfill?
(A) “Free of Particular Average” policy covering Class C risks.
(B) A comprehensive policy covering Institute Cargo Clauses “Class A - All risks”.
(C) Minimal insurance covering only total loss of the vessel.
(D) The buyer is solely responsible for procuring insurance, so the exporter need not fulfill any insurance requirement.

May/June 2021

2. Identify the INCORRECT pair regarding the articles of ISP-98 and their implications:
(A) Article 1.02 - Supplements applicable law to the extent not prohibited by that law.
(B) Article 1.09 - Defines Business Day and Banking Day.
(C) Article 5.01 - Deals with syndication/participation under the standby LC.
(D) Article 3.13 - Deals with Expiration Date on Non-Business Day.

Oct/Nov 2008

3. What is the definition of a Back-to-Back Letter of Credit?
(A) An LC issued by a bank in favour of a local supplier to procure goods on the strength of an export LC received in the exporter’s favour.
(B) An LC issued in favour of a second beneficiary who transfers it back to the original beneficiary after partial execution.
(C) An LC issued by an exporter’s bank in favour of an overseas supplier as a replacement for

an export LC.

- (D) An LC that guarantees compensation to the issuing bank if the negotiating bank fails to reimburse the funds.

May/June 2011

4. Read the following statements regarding Letters of Credit and select the correct option.
I. A Deferred payment LC is similar to an Acceptance LC, except that no bill of exchange or draft is drawn.
II. In a Sight LC, the beneficiary gets payment only after a certain usance period has elapsed from the date of shipment.
(A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

Oct/Nov 2023

5. According to the Uniform Rules for Bank-to-Bank Reimbursements (URR-725), what defines a Reimbursing Bank?
(A) The bank that pays and incurs a deferred payment undertaking and presents a claim for settlement of funds.
(B) The bank that has issued the letter of credit and provided reimbursement authorization to the relevant parties.
(C) The bank that negotiates the export documents and forwards them to the issuing bank for final payment.
(D) The bank accepting the issuing bank’s instructions to provide reimbursement to the claiming bank.

May/June 2007

6. Read the following statements regarding Force Majeure under Article 36 of UCP 600 and select the correct option.
I. Banks assume no responsibility for any loss arising due to the closure of their business by acts of God, riots, or floods.
II. Banks will honour or negotiate under a

NODIA

credit that expired during the force majeure event upon reopening for a grace period of five banking days.

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2019

7. The current update of UCPDC, publication No. 600 of ICC, was implemented with effect from which date?

- (A) 1 January 2007
- (B) 1 July 2007
- (C) 1 April 2008
- (D) 1 January 2009

May/June 2025

8. Under Article 17 of UCP 600, an original document may be defined by which of the following statements?

- I. A document bearing an apparently original signature, mark, stamp, or label of the issuer.
- II. A document that appears to be written, typed, perforated, or stamped by the document issuer.
- III. A document stating it is original, unless the statement appears not to apply to the presented document.

Which of the above statements are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2012

9. Unless otherwise specified in the Letter of Credit, for what amount must an insurance document be issued under UCP 600 Article 34f(ii)?

- (A) 110% of the CIF or CIP value of goods.
- (B) 100% of the FOB value of goods.
- (C) 120% of the gross invoice value.
- (D) 110% of the net weight value of goods.

May/June 2015

10. Consider the following statements regarding the Protection to Banks under UCP 600 Articles 34 to 36:

- I. Banks do not assume any responsibility for the genuineness of the documents

submitted.

II. Banks take responsibility for errors in the translation of technical terms to protect the applicant.

III. Banks assume no liability for consequences arising out of the delay or loss of messages in transmission.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2005

11. What is the fundamental mechanism of a Negotiation Letter of Credit?

- (A) The issuing bank undertakes to give value for documents to the bank that has negotiated them.
- (B) The issuing bank negotiates directly with the buyer to amend the shipping terms before the goods are shipped.
- (C) The advising bank undertakes to warehouse the goods until the buyer makes full payment for the consignment.
- (D) The beneficiary is permitted to draw an advance amount from the issuing bank prior to manufacturing the goods.

May/June 2010

12. Which of the following statements correctly outline the responsibilities of the Issuing Bank?

- I. It must ensure the creditworthiness of the applicant before issuing the LC.
- II. It must examine the documents with reasonable care within five banking days following the receipt of documents.
- III. It must approach the applicant for a waiver of discrepancy solely on its own judgment.
- IV. It must indemnify banks against any obligations imposed by foreign laws.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2022

13. What is the primary objective of the International Standard Banking Practice (ISBP 745)?

- (A) To replace the UCP 600 rules for all domestic letter of credit transactions within

the banking sector.

- (B) To provide practices that practitioners apply to reduce credit rejections due to discrepancies.
- (C) To establish the legal framework for resolving disputes in international commercial courts and tribunals.
- (D) To mandate the exclusive use of electronic documents and digital signatures in all cross-border trade.

May/June 2018

- 14.** Which of the following risks and risk mitigations are relevant to Letter of Credit transactions?
- I. Discrepancies in documents leading to rejection.
 - II. Calling for Bills of Lading in the name of the bank indicating the name and address of the importer.
 - III. Ignoring the exchange control requirements of the seller's country, as they apply only to the advising bank.
 - IV. Obtaining an Exchange Control copy of the licence in favour of the importer for restricted items before opening the LC.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, II, and IV only
 - (C) II, III, and IV only
 - (D) I, III, and IV only

Oct/Nov 2016

- 15.** Regarding the operations of an Export LC, which statement is correct?
- (A) The entry in the EDPMS is closed as soon as the customs clears the consignment for shipment.
 - (B) The exporter's bank scrutinizes the documents and, if compliant, must always forward them to the buyer's bank before negotiating.
 - (C) The overseas buyer approaches their bank to issue the LC only after taking delivery of the goods.
 - (D) The entry in the EDPMS remains outstanding until the exporter's bank receives payment from the overseas buyer's bank.

May/June 2006

- 16.** According to the changes introduced in Incoterms 2020, which of the following statements are correct?
- I. Under FCA, the buyer can instruct its carrier to issue a B/L with an onboard notation to the seller.
 - II. Provisions now allow buyers and sellers to arrange their own transport rather than using a third party for FCA, DAP, DPU, and DDP.
 - III. Under CIP, the default insurance coverage has been downgraded to "Free of Particular Average" Class C.
 - IV. Delivery at Terminal (DAT) is replaced with Delivery at Place Unloaded (DPU).
- Which of the above statements are correct?
- (A) I, II, and III only
 - (B) I, II, and IV only
 - (C) II, III, and IV only
 - (D) I, III, and IV only

Oct/Nov 2020

- 17.** Which of the following is a correct statement concerning the Uniform Rules for Bank-to-Bank Reimbursements (URR-725)?
- (A) The claiming bank is a direct party to the arrangement of reimbursement established under URR-725 protocols.
 - (B) The authorization is independent of the credit and is solely between the issuing and reimbursing bank.
 - (C) The reimbursing bank is bound by all provisions and technical conditions incorporated in the Letter of Credit.
 - (D) The reimbursing bank must request a certificate of compliance from the claiming bank before making the payment.

May/June 2023

- 18.** Identify the requirements that a Bill of Lading must satisfy when presented under a Letter of Credit:
- I. It should be a complete set of negotiable copies as stipulated.
 - II. It should bear the signature of the ship owner or its authorised agent.
 - III. It must bear the Letter of Credit number along with the name of the issuing bank.
 - IV. It must be claused to protect the buyer from damaged goods.
 - V. The date of shipment should be within the

date stipulated in the Letter of Credit.

Which of the above statements are correct?

- (A) I, II, III, and IV only
- (B) I, II, III, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2011

19. Regarding the transport documents under UCP 600, which statement is incorrect?

- (A) Transport documents must bear the clause “clean” to comply with credits requiring “clean on board” documents.
- (B) A bill of lading must indicate the name of the carrier and be signed by the carrier or a specifically named agent.
- (C) Any signature by an agent must indicate whether the agent has signed for or on behalf of the carrier or the master.
- (D) In the case of charter party bills of lading, there is no need to indicate the name of the carrier on the document.

May/June 2014

20. Consider the following statements regarding Standby Letters of Credit and ISP-98:

- I. Standby LCs act as a substitute for a guarantee and are used mostly where banks cannot issue guarantees.
- II. The documents required under a Standby LC are usually bare minimum, like proof of non-performance.
- III. ISP-98 Rule 1.09 defines a Business Day and a Banking Day.
- IV. Standby LCs covering import of goods require no safeguards since they are guaranteed by the regulator.
- V. Invocation of a Commercial Standby LC should be supported by a declaration of the importer’s failure to abide by contractual obligations.

Which of the above statements are correct?

- (A) I, II, III, and V only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2017

21. Which of the following statements about the usage of Standby LCs by Authorized Dealers is incorrect?

- (A) They can be issued as a document of promise

in respect of a non-performance situation.

- (B) They can be established in respect of any debt or obligation incurred by an exporter on account of exports into India.
- (C) Exporters may opt to receive a standby LC in respect of exports from India.
- (D) They can be issued to replace any domestic commercial letter of credit unconditionally.

May/June 2009

22. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option.

Assertion (A): Under UCP 600, a credit is considered irrevocable even if there is no indication to that effect in the document.

Reason (R): UCP 600 explicitly removed the reference to revocable credits to ensure that every credit constitutes a definite undertaking by the issuing bank.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2010

23. Under Article 16 of UCP 600, a bank that refuses documents may exercise any of the following options, EXCEPT:

- (A) Hold documents pending further instructions from the presenter regarding the disposal of the discrepancy.
- (B) Release the documents to the applicant under an indemnity bond without notifying the presenter.
- (C) Return the documents to the presenter via secure courier for further rectification or cancellation.
- (D) Hold documents until it receives a waiver from the applicant and subsequently agrees to accept that waiver.

May/June 2024

24. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option.

Assertion (A): An issuing bank is excused from honouring a complying presentation if the

applicant proves that the beneficiary breached the underlying sales contract.

Reason (R): A credit by its nature is separate from the sale or other contract on which it is based, and banks are in no way bound by such contracts.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2015

25. A Bill of Lading should satisfy all of the following requirements when presented under an LC, EXCEPT:

- (A) It must be a non-negotiable copy issued solely for the records of the advising bank.
- (B) It should bear the signature of the ship owner or its authorized agent.
- (C) It should clearly indicate the payment of freight as per the requirement of the LC.
- (D) It should be issued to the order of the shipper, blank endorsed or endorsed in favour of the issuing bank.

May/June 2013

26. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option.

Assertion (A): If the last date for presentation of documents is a holiday, the Letter of Credit shall automatically be treated as valid on the next working day.

Reason (R): Article 29a of UCP 600 provides that the presentation on the next working day will be treated as valid if the expiry date falls on a day when banks are closed.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2025

27. What is the primary reason the International Chamber of Commerce (ICC) framed the Uniform Customs and Practices for Documentary Credits (UCPDC)?

- (A) To bring uniformity in matters of LC documents so parties interpret terms and are bound by common rules.
- (B) To eliminate the need for banks in international trade by allowing direct buyer-seller document exchange protocols.
- (C) To mandate fixed exchange rates for transactions involving different currencies across multiple continents and zones.
- (D) To enforce penal interest rates on importers who fail to retire their bills on the due date of the transaction.

May/June 2005

28. Based on the scenario where an Indian importer opens a Letter of Credit with a clause allowing advances to a Japanese supplier against proof of warehousing, if the supplier takes the advance but fails to fulfill the export obligations and does not submit the transport documents, who will ultimately bear the loss?

- (A) The Negotiating Bank in Japan
- (B) The Advising Bank in Japan
- (C) The Issuing Bank (Bank X)
- (D) The Reimbursing Bank

Oct/Nov 2013

29. What is the most appropriate description of the role of an Advising Bank under UCP 600?

- (A) It guarantees the payment to the beneficiary regardless of whether the documents are compliant or have discrepancies.
- (B) It checks credit authenticity and advises the LC as the issuing bank's agent without an obligation to honour.
- (C) It assumes all credit risk of the applicant and reimburses the claiming bank directly upon receipt of shipping data.
- (D) It amends the LC automatically if the beneficiary requests a change in the shipping date or quantity of the goods.

May/June 2022

30. In the scenario where Bank Alpha issued an LC on 10.11.2023 with an expiry date of 30.11.2023, if the transport document presented was dated

05.12.2023, what would be the correct action for Bank Alpha?

- (A) Accept it because the expiry date of the LC is flexible under UCP 600.
- (B) Accept it provided the beneficiary pays a discrepancy penalty fee.
- (C) Reject it because documents should not be dated after the expiry date for presentation.
- (D) Forward it to the applicant for forced waiver without notifying the negotiating bank.

Oct/Nov 2006

31. When a dispute arises regarding the quality of goods received under an LC, what is the fundamental principle the banks will rely upon based on UCP 600 Article 4 and 5?
- (A) Banks must inspect the goods physically to resolve the dispute before making final payment to the selling party.
 - (B) Banks are required to physically inspect the shipping containers at the port to verify the quality of the goods.
 - (C) The issuing bank must wait for a formal court injunction before accepting any compliant documents from the seller.
 - (D) Banks deal in documents and not in goods, as the credit is separate from the underlying sales contract.

May/June 2017

32. In the scenario where 1,000 boxes of electronics are shipped under an LC that prohibits partial shipments, if the goods were loaded onto two different vessels leaving on the same day for the same destination, how would the interpretation change under UCP 600?
- (A) It would still not be considered a partial shipment under any circumstances defined in the UCP 600 rules.
 - (B) It would be at the total discretion of the negotiating bank to waive the discrepancy without applicant consent.
 - (C) It would be considered a consolidated shipment and accepted unconditionally by the issuing bank upon receipt.
 - (D) It would be considered a partial shipment, and the documents would be discrepant.

Oct/Nov 2021

33. Arrange the following steps of an Import LC operation in the correct chronological order:
- I. Importer's bank scrutinizes documents and

delivers them to the Importer.

- II. Supplier's Bank negotiates the documents and forwards them to Importer's Bank.
- III. Importer submits copies of documents to the AD Bank to close the entry outstanding in the IDPMS.
- IV. Importer files a Bill of Entry and approaches Customs for taking delivery of goods.
- V. Supplier completes shipment formalities and receives the BL/AWB.

Which of the following sequences represents the correct order?

- (A) V, I, II, IV, III
- (B) V, II, I, IV, III
- (C) II, V, I, III, IV
- (D) II, I, V, IV, III

May/June 2008

34. In the scenario where Bank M received documents on 04.09.2023, if Bank M sent the refusal notice on 12.09.2023, what is the legal consequence?
- (A) The refusal is valid because they were waiting for the applicant's waiver and needed time for internal review.
 - (B) The negotiating bank must refund any reimbursement already received plus any interest accrued during the delay.
 - (C) Bank M is precluded from claiming that the documents do not constitute a complying presentation.
 - (D) The applicant is legally forced to accept the discrepant documents and make payment to the beneficiary at once.

Oct/Nov 2018

35. Match the type of Letter of Credit in List I with its characteristic in List II:

List I: (Type of Letter of Credit)

- P. Sight LC
- Q. Acceptance LC
- R. Deferred Payment LC
- S. Back to Back LC

List II: (Characteristic)

- 1. Bill of Exchange is drawn with a usance period and payable upon acceptance at a future date.
- 2. Beneficiary gets payment on presentation of conforming documents at nominated bank's counters (D/P).
- 3. Issued on the strength of an export LC to procure goods locally.

4. Payable on a certain future date subject to document submission, but no bill of exchange or draft is drawn.

(A) P-1, Q-4, R-3, S-2
(B) P-2, Q-1, R-4, S-3
(C) P-3, Q-2, R-1, S-4
(D) P-4, Q-3, R-2, S-1

May/June 2019

36. Based on the scenario where an Indian issuing bank crystallises a foreign currency liability due to an importer's delay in retiring a bill, from which date will the bank normally recover interest?

(A) From the date of issuance of the LC to the date of crystallisation.
(B) From the date of arrival of goods at the port to the date of crystallisation.
(C) From the date the SWIFT MT 700 was transmitted to the date of crystallisation.
(D) From the date of negotiation to the date of crystallisation.

Oct/Nov 2009

37. Match the definitions under URR 725 in List I with the correct term in List II:

List I: (Definition under URR 725)

- P. Bank that has issued the LC and provided reimbursement authorization.
Q. Bank having accepted authorization instructions to provide reimbursement.
R. Bank that pays, incurs a deferred payment undertaking, or negotiates, and presents a claim.
S. Instructions independent of the credit to reimburse the claiming bank.

List II: (Term)

1. Reimbursing bank
2. Reimbursement authorization
3. Issuing bank
4. Claiming bank
(A) P-3, Q-1, R-4, S-2
(B) P-1, Q-4, R-2, S-3
(C) P-3, Q-2, R-1, S-4
(D) P-4, Q-1, R-3, S-2

May/June 2020

38. In the scenario where a beneficiary submits an insurance policy dated 15.08.2023 for a shipment with a Bill of Lading dated 18.08.2023, is the date of the insurance policy acceptable under UCP 600?

- (A) No, it must be dated exactly on the day of shipment.
(B) No, because it must be dated after the transport document is issued to prove the goods are in transit.
(C) Yes, because it is dated on or before the date of shipment.
(D) Yes, but only if it contains an exclusion clause.

Oct/Nov 2024

39. Identify the correct pair of Incoterm acronym and its full form:

(A) FCA - Freight and Carriage Allowed
(B) DAT - Delivered At Terminal
(C) CFR - Carriage and Freight Required
(D) DDP - Delivered Duty Pending

May/June 2016

40. Based on the scenario of a bank issuing a Standby Letter of Credit subject to ISP-98, which of the following is an essential document generally required to be presented to invoke a Commercial Standby LC?

(A) A declaration that the claim is made due to the importer's failure to abide by contractual obligations.
(B) A complete health and phytosanitary certificate issued by the relevant national agricultural authorities.
(C) A full set of original clean on board bills of lading issued by a reputable and authorized international carrier.
(D) An original certificate of origin issued and authenticated by the local chamber of commerce in the exporter's city.

Oct/Nov 2007

41. Identify the INCORRECT pair regarding document requirements under an LC:

(A) Bill of Lading - Should generally be dated prior to the date of issuance of the LC.
(B) Bill of Exchange - Must be drawn in the currency of the LC unless otherwise specified.
(C) Invoice - Must not exceed the LC value.
(D) Insurance Policy - Should be issued for an amount of at least 110% of CIF/CIP value if not specified.

May/June 2012

42. A documentary credit or letter of credit is defined as:
- (A) An irrevocable undertaking by the advising bank to supply goods to the buyer against specific documents and clearances.
 - (B) A banker's authenticated instrument undertaking to pay the seller upon presentation of complying documents.
 - (C) A formal contract of sale between the buyer and seller guaranteeing the quality and quantity of goods shipped.
 - (D) A financial guarantee issued by the negotiating bank ensuring the physical delivery of goods to the importer.

Oct/Nov 2014

43. Read the following statements regarding Revocable Credits under UCP 600 and select the correct option.
- I. UCP 600 includes detailed provisions for amending Revocable Credits without notifying the seller.
 - II. The term Revocable Credits ceases to exist in UCP 600, and a credit is irrevocable even if there is no indication to that effect.
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

May/June 2021

44. How is a Standby Letter of Credit primarily defined in international trade?
- (A) A primary payment instrument used to settle all standard trade invoices immediately upon shipment of the goods.
 - (B) An advance payment mechanism enabling the supplier to purchase raw materials before the start of production.
 - (C) A guarantee-like instrument protecting against default and invoked in cases of non-performance.
 - (D) A conditional credit facility that automatically converts into a term loan upon the arrival of goods.

Oct/Nov 2008

45. Read the following statements based on Article 31 of UCP 600 regarding partial shipments and select the correct option.
- I. A presentation consisting of more than

one set of transport documents covering shipment on the same means of transport for the same journey will not be considered as a partial shipment.

- II. Such multiple sets of transport documents will be considered partial shipment if they indicate different dates of shipment.

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2011

46. In which year was the Uniform Customs and Practices for Documentary Credits (UCPDC) first framed and brought out by the International Chamber of Commerce?
- (A) 1920
 - (B) 1929
 - (C) 1933
 - (D) 1951

Oct/Nov 2023

47. Consider the following terms defined under the section of Definitions and Interpretations (Articles 2 and 3) in UCP 600:
- I. Complying presentation
 - II. Banking day
 - III. Force Majeure grace period
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2007

48. Under UCP 600 Article 14, what is the maximum time allowed to banks to accept or refuse presented documents?
- (A) A reasonable time not exceeding 7 banking days following the day of presentation.
 - (B) 5 calendar days following the day of presentation.
 - (C) 21 days after the date of issuance of the transport document.
 - (D) 5 banking days following the day of presentation.

Oct/Nov 2019

49. Consider the following statements regarding Insurance Documents under Article 28 of UCP 600:

- I. Banks will not accept an insurance document that contains reference to any exclusion clause.
- II. "Proxies" can now sign on behalf of the insurance company or underwriter.
- III. The percentage to be covered will be understood as a "minimum" coverage required.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2025

50. In the context of Letters of Credit, which of the following accurately describes an Irrevocable Confirmed Letter of Credit?
- (A) An LC where the issuing bank adds an additional condition that it can be cancelled if the buyer rejects the goods upon physical inspection.
 - (B) An LC where the advising bank guarantees payment only if the issuing bank provides advance funds before negotiation.
 - (C) An LC incorporating an additional undertaking by a bank other than the issuing bank to pay on receipt of complying documents.
 - (D) An LC that can be transferred to multiple second beneficiaries without the consent of the issuing bank.

Oct/Nov 2012

51. When establishing commercial standby LCs for import of goods into India, identify which of the following safeguards may be taken:
- I. The facility may be extended only to independent power producers or Special category importers like Export Houses.
 - II. A satisfactory credit report on the overseas supplier should be obtained prior to the issue.
 - III. The beneficiary does not need to furnish any declaration regarding the failure of the importer to abide by contractual obligations.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2015

52. What does the term "Crystallisation of Foreign Currency Liability" refer to in the handling of import bills drawn under an LC?
- (A) The process of returning the discrepant documents to the negotiating bank and reversing the foreign currency entries.
 - (B) The automatic cancellation of the LC liability when the goods arrive at the customs warehouse for inspection.
 - (C) The uploading of the export bill data onto the EDPMS platform by the authorized dealer for regulatory compliance.
 - (D) The conversion of the foreign currency debt into Indian rupees on a set day if the bill is not retired.

Oct/Nov 2005

53. Regarding the follow-up of bills under LC and Crystallisation, which of the following statements are correct?
- I. For sight bills not retired by the importer, the foreign currency liability is crystallised into Indian rupees after a maximum period as per the individual Bank's policy.
 - II. The crystallisation can be effected earlier than the stipulated day if there is a specific written request from the importer.
 - III. For usance bills, the foreign currency liability is crystallized into Indian rupees on the due date.
 - IV. Banks recover penal interest from the date of negotiation to the date of crystallisation.
- Which of the above statements are correct?
- (A) I, II, and III only
 - (B) II, III, and IV only
 - (C) I, III, and IV only
 - (D) I, II, and IV only

May/June 2010

54. Which of the following statements correctly describes a Revolving Letter of Credit?
- (A) It allows the buyer to cancel the LC at any time without the seller's consent.
 - (B) It permits the transfer of the LC to a second beneficiary who can then transfer it to a third beneficiary.
 - (C) It is used when a buyer requests partial deliveries at specific intervals, covering the value of each consecutive instalment.
 - (D) It provides an advance payment to the seller against a warehousing receipt for the goods.

Oct/Nov 2022

55. Under the Uniform Rules for Bank-to-Bank Reimbursements (URR 725), which of the following liabilities and responsibilities apply?
- The issuing bank must not request a certificate of compliance to be submitted by the claiming bank to the reimbursing bank.
 - The reimbursement authorization must have a strict expiry date.
 - The reimbursing bank is not obliged to honour a claim, except where there is a reimbursement undertaking.
 - Reimbursement authorization must be issued by authenticated means and no mail confirmation should be sent.
- Which of the above statement(s) is/are correct?
- I, II, and III only
 - II, III, and IV only
 - I, III, and IV only
 - I, II, III, and IV

May/June 2018

56. Which statement accurately reflects a change brought by UCP 600 regarding Non-Matching Documents (Article 14)?
- Data in a document need not be identical but must not conflict with data in any other document.
 - Documents that are “on their face” inconsistent with one another must be rejected as discrepant by the bank.
 - Data in all documents must mirror each other exactly, character by character, to be considered compliant by banks.
 - Inconsistencies between documents are acceptable provided the beneficiary provides a suitable indemnity bond.

Oct/Nov 2016

57. While examining an invoice under a Letter of Credit, identify which of the following points should be verified:
- It should be made out by the seller/beneficiary as stipulated in the LC.
 - It should be made out in the name of the applicant of the LC (unless specified otherwise).
 - The invoice value must not exceed the LC value.
 - Terms of sale contract such as FOB or CIF should be indicated.
 - It must always be countersigned by the local

Chamber of Commerce.

Which of the above statements are correct?

- I, II, III, and IV only
- I, III, IV, and V only
- II, III, IV, and V only
- I, II, IV, and V only

May/June 2006

58. Which of the following statements regarding a Transferable Letter of Credit is incorrect?
- It is available for transfer in full or in part by the advising bank at the request of the issuing bank.
 - The second beneficiary has the right to further transfer the LC in favour of another third party.
 - A transferable credit can be split and transferred in favour of more than one second beneficiary.
 - To be transferable, a credit must specifically state that it is transferable.

Oct/Nov 2020

59. Identify the requirements for an Insurance Policy or Certificate presented under a Letter of Credit:
- It must be issued and signed by the insurance company or their agents.
 - It should not be issued by the broker.
 - The currency of issuance must be the same as the currency of the LC.
 - Claims should be made payable in the country of the applicant.
 - The policy must be endorsed strictly in favour of the advising bank only.
- Which of the above statements are correct?
- I, II, III, and V only
 - I, II, III, and IV only
 - II, III, IV, and V only
 - I, III, IV, and V only

May/June 2023

60. Identify the incorrect statement regarding Incoterms 2020 responsibilities.
- Under FCA, the buyer may instruct its carrier to issue a Bill of Lading with an onboard notation to the seller.
 - Under DDP (Delivered Duty Paid), the seller bears the responsibility for destination port charges, customs clearance, and customs duties.
 - Under EXW (Ex-Works), the seller has the

maximum responsibility, including loading the goods at the port of origin.

- (D) Under CIF, the seller is responsible for the ocean and air freight as well as providing insurance.

Oct/Nov 2011

- 61.** Identify the valid provisions under URR 725 for Authorizations, Amendments, and Claims:
- I. All authorizations must be issued in the form of authenticated tele-transmission or signed letter.
 - II. The reimbursing bank has the right to accept or reject any amendments.
 - III. An irrevocable reimbursement authorization cannot be amended without the agreement of the reimbursing bank.
 - IV. The claiming bank must claim reimbursement in the form of tele-transmission unless prohibited by the issuing bank.
 - V. Reimbursing bank shall have up to seven banking days to process the claims.
- Which of the above statements are correct?
- (A) I, II, III, and IV only
 - (B) I, II, IV, and V only
 - (C) II, III, IV, and V only
 - (D) I, III, IV, and V only

May/June 2014

- 62.** All of the following parties are typically directly involved in a standard Letter of Credit transaction, EXCEPT:
- (A) The applicant
 - (B) The issuing bank
 - (C) The customs clearing agent
 - (D) The advising bank

Oct/Nov 2017

- 63.** In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option.
- Assertion (A): Banks do not assume any responsibility for the genuineness of the documents submitted under a Letter of Credit.
- Reason (R): Under documentary credit operations, all parties deal in documents and not in goods.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true,

but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2009

- 64.** While preparing or examining an invoice for an LC, all of the following specific points must be ensured, EXCEPT:
- (A) It should be made out in the name of the applicant or open of the LC unless the credit otherwise specifies.
 - (B) The standard terms of sale contract, such as FOB or CIF, should be clearly indicated on the invoice document.
 - (C) The full description of goods must strictly correspond with the description given in the letter of credit.
 - (D) The invoice value must exceed the LC value by 5% to account for exchange rate fluctuations.

Oct/Nov 2010

- 65.** In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option.
- Assertion (A): The reimbursing bank charges should normally be for the account of the issuing bank.
- Reason (R): The reimbursement authorization is completely independent of the credit and the reimbursing bank is not bound by any provisions of the Letter of Credit.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2024

- 66.** Under the Incoterms 2020 classification "Main Carriage Paid", all of the following terms are included, EXCEPT:
- (A) CFR (Cost and Freight)
 - (B) CIF (Cost, Insurance and Freight)
 - (C) FCA (Free Carrier)
 - (D) CIP (Carriage and Insurance Paid to)

Oct/Nov 2015

67. Based on the following scenario, identify the specific type of clause incorporated into the Letter of Credit:

An importer in India requests Bank X to open a Letter of Credit in favour of a supplier in Japan. The supplier requires funds prior to manufacturing the goods. The LC includes a specific clause permitting the negotiating bank to advance funds to the supplier. Additionally, the clause requires the supplier to submit a receipt, a written undertaking to deliver transport documents, and documentary proof that the goods to be shipped have been warehoused.

- (A) Green Clause
- (B) Red Clause
- (C) Standby Clause
- (D) Revolving Clause

May/June 2013

68. Which of the following best describes the difference between a “Red Clause” LC and a “Green Clause” LC?

- (A) A Red Clause LC requires goods to be shipped before the advance is paid, while a Green Clause LC pays upon order.
- (B) A Red Clause LC is used exclusively for export of software, whereas a Green Clause LC is used for physical goods.
- (C) A Red Clause LC does not permit partial shipments, whereas a Green Clause LC permits unlimited partial shipments.
- (D) A Red Clause advance is paid against an undertaking, while a Green Clause also requires proof of warehousing.

Oct/Nov 2025

69. Based on the following scenario, how should Bank Alpha treat the presentation regarding the date of the commercial invoice?

Bank Alpha issues an LC dated 10.11.2023. The LC is silent on whether documents can be dated prior to the LC issuance date. The beneficiary presents documents for negotiation. The commercial invoice is dated 05.11.2023, while the transport document shows a shipment date of 12.11.2023. The expiry date for presentation is 30.11.2023.

- (A) Reject the documents immediately because the invoice is dated five days prior to the date of credit issuance.
- (B) Reject the documents because an invoice

must always bear the exact same date as the transport document itself.

- (C) Hold the documents until the beneficiary issues a newly dated invoice that matches the shipment date exactly.
- (D) Accept the documents because Article 14(i) allows documents dated prior to the date of credit.

May/June 2005

70. What is the most effective safeguard a bank should implement when sanctioning an LC facility for an importer, especially for large value transactions?

- (A) Rely entirely on the importer’s verbal commitment to retire the bills upon presentation at the counter of the bank.
- (B) Advise the importer to issue a revocable LC so that it can be cancelled if the market demand drops or shifts suddenly.
- (C) Ensure the importer offers a margin, follow due diligence, and obtain a credit report on the overseas seller.
- (D) Waive the requirement of submitting the Bill of Entry to speed up the transaction process and release the cargo.

Oct/Nov 2013

71. Based on the following scenario, how should the issuing bank interpret this presentation under Article 31 of UCP 600?

A beneficiary hands over 1,000 boxes of electronics to a shipping company under an LC. The shipping company issues one Bill of Lading for 400 boxes on 10.05.2023 and a second Bill of Lading for 600 boxes on 12.05.2023. Both consignments are loaded onto the same vessel, which departs on 14.05.2023 for the same destination. The LC explicitly states “Partial shipment is not allowed.”

- (A) As a partial shipment, and reject the documents because multiple transport documents were issued by the carrier.
- (B) Not partial shipment, as goods are on the same means of transport and have the same journey.
- (C) As a partial shipment, and reject the documents because the BLs have different dates of shipment from each other.
- (D) Not as a partial shipment, but reject the documents because the quantities on the BLs are unequal and inconsistent.

May/June 2022

72. Arrange the following steps of an Export LC operation in the correct chronological order:

- I. Exporter's Bank/Nominated Bank scrutinizes the documents and negotiates or forwards them to the Buyer's Bank.
- II. Overseas buyer approaches their Bank requesting issuance of an LC.
- III. Exporter completes customs formalities and shipment by filing copies of documents with the Carrier.
- IV. LC issuing Bank transmits the MT 700 to the Exporter's Bank.
- V. Buyer's Bank scrutinizes the documents and delivers them to the Importer against payment or acceptance.

Which of the following sequences represents the correct order?

- (A) II, IV, III, I, V
- (B) II, III, IV, I, V
- (C) IV, II, I, III, V
- (D) II, IV, I, III, V

Oct/Nov 2006

73. Based on the following scenario, what is the deadline for Bank M to give notice of refusal according to Article 16 of UCP 600?

Bank M receives documents under a sight LC on Monday, 04.09.2023. The bank's document checker identifies a discrepancy. The bank seeks a waiver from the applicant but receives no reply. (Assume Saturday and Sunday are non-banking days).

- (A) Monday, 11.09.2023 (Closing hours)
- (B) Wednesday, 06.09.2023 (Closing hours)
- (C) Friday, 08.09.2023 (Closing hours)
- (D) Tuesday, 12.09.2023 (Closing hours)

May/June 2017

74. Match the UCP revision in List I with the key provision introduced or highlighted in List II:

List I: (UCP Revision)

- P. UCP 151 (1951)
- Q. UCP 290 (1974)
- R. UCP 400 (1983)
- S. UCP 500 (1993)

List II: (Key Provision)

1. Introduction of the term "nomination" and its use.
2. The concept that "all parties deal in documents and not in goods" was highlighted.

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3. Defined "credit is irrevocable" if the document is silent on this issue.
4. Introduction of the term "Deferred Payment Undertaking" as a settlement means.

- (A) P-2, Q-1, R-4, S-3
- (B) P-1, Q-2, R-3, S-4
- (C) P-3, Q-4, R-1, S-2
- (D) P-4, Q-3, R-2, S-1

Oct/Nov 2021

75. Based on the following scenario, what action must the issuing bank take during crystallisation? *An importer's sight bill drawn under an LC is received at the issuing bank's counters in India on 01.10.2023 in US Dollars. The importer does not retire the bill within the maximum period allowed by the bank's policy. The bank decides to crystallise the foreign currency liability.*

- (A) Convert the currency into rupees at the prevailing Bill Selling Rate or the forward contract rate.
- (B) Convert the foreign currency liability into Indian rupees at the prevailing Bill Buying Rate of the local bank.
- (C) Automatically debit the overseas supplier's account for the outstanding amount including all miscellaneous fees.
- (D) Extend the LC validity by 30 days and wait for the importer to arrange funds or provide suitable collateral.

May/June 2008

76. Match the UCP 600 Article groupings in List I with their subject matter in List II:

List I: (UCP 600 Article Groupings)

- P. Articles 1-5
- Q. Articles 6-10
- R. Articles 19-27
- S. Articles 34-37

List II: (Subject Matter)

1. Transport documents.
2. Disclaimers.
3. Definitions, Interpretations, Independence of LCs.
4. Availability, Expiry date and place, Obligations of issuing and Confirming bank.

- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-4, R-1, S-2
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2018

77. Based on the following scenario, is the insurance cover amount compliant with UCP 600 requirements?

An LC for USD 50,000 requires an insurance policy covering all risks. The invoice value of the goods is USD 50,000. The LC is silent on the required extent of insurance cover. The beneficiary submits an insurance policy dated 15.08.2023, whereas the Bill of Lading is dated 18.08.2023. The insurance policy covers an amount of USD 52,000.

- (A) Yes, because the amount of USD 52,000 is clearly more than the total invoice value of the electronics shipped.
- (B) No, if the LC is silent, cover must be at least 110% of CIF/CIP value, totaling USD 55,000.
- (C) No, because if the LC is silent, the cover must be exactly 100% of the invoice value for the specific shipment.
- (D) Yes, because the insurance policy was issued and signed three days before the actual shipment date of the goods.

May/June 2019

78. Match the Incoterms Categories in List I with the corresponding term in List II:

List I: (Incoterms Category)

- P. Departure
- Q. Main Carriage Paid
- R. Main Carriage Unpaid
- S. Arrival

List II: (Term)

- 1. DPU (Delivered At Place Unloaded)
- 2. EXW (Ex-Works)
- 3. FAS (Free Alongside Ship)
- 4. CPT (Carriage Paid To)

- (A) P-2, Q-4, R-3, S-1
- (B) P-1, Q-3, R-4, S-2
- (C) P-3, Q-1, R-2, S-4
- (D) P-4, Q-2, R-1, S-3

Oct/Nov 2009

79. Based on the following scenario, how is the expiration date handled according to ISP-98 (Article 3.13)?

A bank issues a Standby Letter of Credit subject to ISP-98. The expiry date mentioned in the Standby LC falls on a Sunday, which is a non-business day for the bank. The beneficiary presents the claim documents on the following Monday.

- (A) The expiry date is strictly enforced, and the

presentation on Monday is deemed invalid by the bank's rules.

- (B) The beneficiary must request a formal amendment from the applicant to validate the presentation of documents.
- (C) The bank will honour the claim only if a documented force majeure event occurred during the previous week.
- (D) The presentation on Monday is acceptable as the expiry date extends to the next business day.

May/June 2020

80. Identify the correct pair regarding the parties to an LC and their responsibilities:

- (A) Applicant - Scrutinizes documents independently and makes the final payment to the beneficiary at their bank.
- (B) Confirming Bank - Authenticates the LC but has no legal obligation to pay on behalf of the original issuing bank.
- (C) Reimbursing Bank - Assumes full responsibility for any delay or loss in transit of messages between the parties.
- (D) Negotiating Bank - Examines documents as per UCP and negotiates if they appear to comply on their face.

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ANSWERS

1. (B) A comprehensive policy covering Institute Cargo Clauses "Class A - All risks".
Under Incoterms 2020, the Carriage and Insurance Paid to rule requires the seller to obtain insurance coverage that complies with Institute Cargo Clauses Class A or similar. This represents comprehensive all-risk coverage. This requirement differs from CIF, which only mandates minimal Class C coverage. Sellers must provide this higher protection unless otherwise agreed upon by both parties.
2. (C) Article 5.01 - Deals with syndication/participation under the standby LC.
The International Standby Practices 98 provide a comprehensive framework for standby letters of credit. Article 5.01 specifically addresses the issuer's obligation to examine documents and give notice of dishonor. It does not deal with syndication or participation. Syndication and participation are instead governed by different sections within the rules, ensuring clear distinctions in various operational procedures.
3. (A) An LC issued by a bank in favour of a local supplier to procure goods on the strength of an export LC received in the exporter's favour.
A back-to-back letter of credit is a separate credit issued based on an existing export letter of credit. Banks issue this instrument in favor of local suppliers to facilitate the procurement of goods required for export. It allows intermediaries to purchase products using the creditworthiness of the original buyer's issuing bank as indirect collateral support for the transaction.
4. (A) Only I
Deferred payment letters of credit function similarly to acceptance credits because they involve payments at a future date. However, they are distinguished by the absence of a formal bill of exchange or draft. Conversely, a sight credit requires immediate payment upon presentation of complying documents, rather than waiting for a usance period or a specific maturity date.
5. (D) The bank accepting the issuing bank's instructions to provide reimbursement to the claiming bank.
Under the Uniform Rules for Bank-to-Bank Reimbursements 725, a reimbursing bank is defined as the institution that accepts instructions from the issuing bank. Its role is to provide reimbursement to the claiming bank upon request. This arrangement is independent of the underlying credit and governed by specific authorization provided by the issuing financial institution to the parties.
6. (A) Only I
Article 36 of the Uniform Customs and Practice for Documentary Credits states that banks are not liable for business interruptions caused by acts of God or riots. When a bank reopens after such a force majeure event, it will not honor or negotiate under a credit that expired during the period the business was closed for its operations.
(B) 1 July 2007
The International Chamber of Commerce introduced the Uniform Customs and Practice for Documentary Credits publication number 600 to modernize trade rules. This version was officially implemented globally on July 1, 2007. It replaced the previous UCP 500 rules, aiming to reduce discrepancies and provide clearer definitions for banks and traders involved in international documentary credit transactions worldwide.
8. (D) I, II, and III
Article 17 of the Uniform Customs and Practice for Documentary Credits defines original documents through multiple criteria. A document is considered original if it bears an authentic signature, stamp, or label. Furthermore, documents produced by typing, perforating, or stamping by the issuer qualify. Any document stating it is an original is accepted unless the statement is clearly inapplicable.
9. (A) 110% of the CIF or CIP value of goods.
According to the Uniform Customs and Practice for Documentary Credits, specific insurance

requirements apply when the credit is silent on the amount. The insurance document must be issued for a minimum of one hundred and ten percent of the CIF or CIP value of the goods. This standard ensures adequate protection for buyers against loss during international carriage.

10. (B) I and III only

The Uniform Customs and Practice for Documentary Credits provide significant protection to banks during trade transactions. Banks assume no responsibility for the genuineness of documents or the legal status of issuers. Additionally, they are not liable for delays or losses occurring during message transmission. However, banks must ensure accurate document examination rather than assuming technical translation risks.

11. (A) The issuing bank undertakes to give value for documents to the bank that has negotiated them.
In a negotiation letter of credit, the issuing bank provides an undertaking to give value to a nominated bank that has negotiated complying documents. Negotiation involves the purchase by the nominated bank of drafts or documents under a complying presentation. The primary mechanism ensures the beneficiary receives funds while the negotiating bank is reimbursed by the issuer.

12. (A) I, II, and III only

An issuing bank must evaluate an applicant's creditworthiness before opening a credit. It is required to examine presented documents within five banking days to determine compliance. While the bank may seek a waiver for discrepancies from the applicant, it does so based on its own judgment. These duties are fundamental to the regular operation of documentary credits.

13. (B) To provide practices that practitioners apply to reduce credit rejections due to discrepancies.
International Standard Banking Practice 745 serves as a companion guide to the Uniform Customs and Practice for Documentary Credits. Its primary objective is to describe how banks should examine documents under letters of credit. By establishing uniform practices, it helps practitioners minimize document rejections due to discrepancies, thereby facilitating smoother

settlements in international trade and finance operations.

14. (B) I, II, and IV only

Letter of credit transactions involve risks like document discrepancies and non-compliance with exchange control regulations. Risk mitigation includes naming the bank on bills of lading and ensuring importers obtain necessary licenses for restricted items. Parties must adhere to the exchange control requirements of the buyer's country, as these regulations impact the validity and settlement of the transaction.

15. (D) The entry in the EDPMS remains outstanding until the exporter's bank receives payment from the overseas buyer's bank.

In export letter of credit operations, regulatory compliance involves tracking payments through systems like the Export Data Processing and Monitoring System. An entry in this system remains outstanding until the exporter's bank confirms the receipt of payment from the overseas buyer's bank. This ensures that all exported goods are properly accounted for and the proceeds are eventually repatriated.

16. (B) I, II, and IV only

Incoterms 2020 introduced several updates to international trade terms. Key changes include allowing buyers and sellers to use their own transport instead of third parties for specific rules. Furthermore, the term Delivered at Terminal was officially replaced by Delivered at Place Unloaded. In Free Carrier arrangements, buyers can now instruct carriers to provide onboard notations on bills.

17. (B) The authorization is independent of the credit and is solely between the issuing and reimbursing bank.

The Uniform Rules for Bank-to-Bank Reimbursements 725 establish that a reimbursement authorization is a separate transaction from the letter of credit itself. It represents an independent arrangement between the issuing bank and the reimbursing bank. The reimbursing bank is not bound by the terms of the credit, and the claiming bank is not a direct party.

- 18.** (B) I, II, III, and V only
A bill of lading must satisfy several criteria to be considered a complying document under a letter of credit. It must be presented as a complete negotiable set signed by the carrier, master, or a named agent. The document does not need to mention the credit number or the issuing bank unless specifically required. Additionally, the shipment date must fall within the timeframe specified in the credit.
- 19.** (A) Transport documents must bear the clause “clean” to comply with credits requiring “clean on board” documents.
Under the Uniform Customs and Practice for Documentary Credits, transport documents do not need to specifically bear the word clean to comply with requirements. A document is considered clean if it does not contain clauses or notations that expressly declare a defective condition of the goods or packaging. Banks will accept such documents as meeting the clean on board requirement.
- 20.** (A) I, II, III, and V only
Standby letters of credit function as default instruments when a party fails to perform contractual duties. They are governed by the International Standby Practices 98, which define essential terms like business days. In commercial standby arrangements, the beneficiary typically provides a declaration of the importer’s failure to perform. These instruments require minimal documentation compared to standard commercial credits.
- 21.** (D) They can be issued to replace any domestic commercial letter of credit unconditionally.
Authorized dealers in India are permitted to issue standby letters of credit for specific non-performance situations and export-related obligations. However, they cannot use these instruments to unconditionally replace any domestic commercial credit without following specific regulatory guidelines. The issuance is generally restricted to certain categories of trade and requires adherence to safeguards established by the central regulator.
- 22.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The Uniform Customs and Practice for Documentary Credits publication 600 simplifies trade by treating every credit as irrevocable. This means that once issued, a credit cannot be amended or cancelled without the consent of the issuing bank, the confirming bank, and the beneficiary. This default status provides security to the seller, ensuring a definite undertaking by the bank.
- 23.** (B) Release the documents to the applicant under an indemnity bond without notifying the presenter.
When a bank refuses documents under Article 16, it must notify the presenter and specify the discrepancies. The bank can hold documents for instructions, return them, or wait for a waiver. However, it is strictly prohibited from releasing documents to the applicant under an indemnity without informing the presenter, as this would violate the rules of documentary credits.
- 24.** (D) Assertion (A) is false, but Reason (R) is true.
The independence principle is a cornerstone of documentary credit law. A letter of credit is a transaction separate from the underlying sales contract. Consequently, an issuing bank must honor a complying presentation regardless of claims regarding breaches of the sales contract. Banks deal strictly with documents and are not responsible for the actual performance of the commercial agreement.
- 25.** (A) It must be a non-negotiable copy issued solely for the records of the advising bank.
To fulfill the requirements of a letter of credit, a bill of lading must be a negotiable document rather than a non-negotiable copy. It must be signed by the carrier or agent and clearly indicate freight payment status. Furthermore, it should be issued to the order of the shipper or endorsed in favor of the bank to ensure control.
- 26.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Article 29 of the Uniform Customs and Practice for Documentary Credits addresses situations where the expiry date for presentation falls on

a day when the bank is closed for business. In such instances, the period for presentation is automatically extended to the first following banking day. This ensures that beneficiaries are not unfairly penalized by calendar-related bank closures during trade.

- 27.** (A) To bring uniformity in matters of LC documents so parties interpret terms and are bound by common rules.

The International Chamber of Commerce established the Uniform Customs and Practice for Documentary Credits to standardize international trade procedures. These rules create a common language and framework that parties across different countries must follow. By providing uniformity in document interpretation, the rules help reduce disputes and ensure that all participating banks and traders understand their rights and obligations.

- 28.** (C) The Issuing Bank (Bank X)

Under a green clause letter of credit, the issuing bank authorizes advances to the supplier against proof of warehousing. If the supplier fails to ship the goods or submit documents after receiving the advance, the issuing bank remains liable for the funds. The issuing bank ultimately bears the financial loss because it provided the undertaking to advance those funds.

- 29.** (B) It checks credit authenticity and advises the LC as the issuing bank's agent without an obligation to honour.

An advising bank acts as an agent of the issuing bank to communicate the credit to the beneficiary. Its primary responsibility is to verify the apparent authenticity of the credit. By advising the letter of credit, the bank does not undertake any obligation to honor or negotiate the documents unless it also adds its confirmation to the transaction.

- 30.** (C) Reject it because documents should not be dated after the expiry date for presentation. According to the principles of documentary credits, documents must be presented within the validity period of the credit. If a transport document is dated after the expiry date, it constitutes a major discrepancy. The issuing bank must reject such a presentation because it no longer holds a valid undertaking to pay

for documents that do not meet the timeframe requirements.

- 31.** (D) Banks deal in documents and not in goods, as the credit is separate from the underlying sales contract.

Articles 4 and 5 of the Uniform Customs and Practice for Documentary Credits establish that banks deal solely in documents and not in the physical goods. Credits are separate from the sales contracts they support. Therefore, banks are not responsible for resolving quality disputes or inspecting cargo. They must pay if the presented documents appear to be a complying presentation.

- 32.** (D) It would be considered a partial shipment, and the documents would be discrepant.

Under the Uniform Customs and Practice for Documentary Credits, shipments on different vessels are considered partial shipments even if the vessels depart on the same day for the same destination. If the credit prohibits partial shipments, loading goods on two separate vessels creates a discrepancy. The issuing bank is justified in rejecting the documents as they violate the credit terms.

- 33.** (B) V, II, I, IV, III

An import letter of credit operation follows a specific chronological sequence. First, the supplier completes shipment and receives transport documents. Next, the supplier's bank negotiates and forwards these documents to the importer's bank. The importer's bank then scrutinizes and delivers them to the importer. Finally, the importer files a bill of entry and later closes the outstanding regulatory entry.

- 34.** (C) Bank M is precluded from claiming that the documents do not constitute a complying presentation.

Article 16 of the Uniform Customs and Practice for Documentary Credits requires banks to give notice of refusal within five banking days. If a bank fails to provide this notice within the stipulated timeframe, it is precluded from claiming that the documents are discrepant. Consequently, the bank becomes liable to honor the presentation as if it were perfectly compliant.

35. (B) P-2, Q-1, R-4, S-3

Letters of credit have distinct characteristics based on their type. A sight credit requires payment upon presentation of documents. An acceptance credit involves a usance bill of exchange payable at a future date. A deferred payment credit is similar but lacks a bill of exchange. Finally, a back-to-back credit is issued locally on the strength of an export credit.

36. (D) From the date of negotiation to the date of crystallisation.

When an importer fails to retire a bill, the bank crystallizes the liability into local currency. To compensate for the funds utilized, the bank recovers interest from the date the negotiation occurred at the foreign center until the date of crystallization. This ensures the bank is reimbursed for the period it held the foreign exchange exposure on behalf of the importer.

37. (A) P-3, Q-1, R-4, S-2

The Uniform Rules for Bank-to-Bank Reimbursements 725 define the roles of various institutions. The issuing bank provides the reimbursement authorization. The reimbursing bank is the entity that accepts instructions to provide funds. The claiming bank is the one that presents the claim for settlement after paying the beneficiary. These instructions remain independent of the actual letter of credit.

38. (C) Yes, because it is dated on or before the date of shipment.

Under the Uniform Customs and Practice for Documentary Credits, an insurance document must be dated no later than the date of shipment. If an insurance policy is dated before the bill of lading, it is acceptable because it ensures the goods were covered before the transit began. This compliance ensures that there is no gap in coverage during the journey.

39. (B) DAT - Delivered At Terminal

Incoterms are standardized trade terms used globally to define the responsibilities of buyers and sellers. The acronym DAT stands for Delivered at Terminal, which was a specific term in previous versions. Although replaced by DPU in 2020, it remains a recognized term in trade history. Correct identification of these terms is vital for accurately determining costs and risks.

40. (A) A declaration that the claim is made due to the importer's failure to abide by contractual obligations.

To invoke a commercial standby letter of credit, the beneficiary must typically present a statement or declaration. This document must state that the claim is being made because the importer failed to fulfill their contractual obligations. Unlike standard credits, standby credits require minimal documentation, often just this declaration of non-performance rather than a full set of shipping documents.

41. (A) Bill of Lading - Should generally be dated prior to the date of issuance of the LC.

A bill of lading should generally be dated after the issuance of the letter of credit, although UCP 600 allows earlier dates unless prohibited. Invoices must be issued by the beneficiary and must not exceed the credit value. Insurance documents must meet minimum coverage requirements. A bill of exchange must match the currency of the credit to be considered compliant.

42. (B) A banker's authenticated instrument undertaking to pay the seller upon presentation of complying documents.

A letter of credit is a financial instrument issued by a bank that provides an irrevocable undertaking to pay a seller. This payment is contingent upon the presentation of documents that strictly comply with the terms and conditions specified in the credit. It acts as a bridge of trust between buyers and sellers in international trade by substituting bank credit.

43. (B) Only II

One of the most significant changes in the UCP 600 was the removal of all references to revocable letters of credit. Under these rules, every credit is deemed to be irrevocable even if it does not explicitly state so. This change was implemented to provide greater security to beneficiaries and ensure that banks cannot cancel credits without mutual agreement.

44. (C) A guarantee-like instrument protecting against default and invoked in cases of non-performance.

A standby letter of credit is a specialized financial instrument that serves as a secondary payment mechanism. It acts similarly to a bank guarantee,

providing protection against the risk of default or non-performance by a party. It is only intended to be drawn upon if the applicant fails to fulfill their obligations under the underlying contract with the beneficiary.

45. (A) Only I

According to Article 31 of the Uniform Customs and Practice for Documentary Credits, multiple sets of transport documents are not considered a partial shipment if they cover the same journey on the same means of transport. This rule applies even if the documents show different shipment dates, provided the goods are on the same vessel or vehicle for the trip.

46. (C) 1933

The International Chamber of Commerce first introduced the Uniform Customs and Practice for Documentary Credits in 1933. This landmark publication was created to standardize the rules governing letters of credit globally. Since its inception, it has undergone several revisions to keep pace with the evolving needs and complexities of international banking and commercial trade practices throughout the years.

47. (A) I and II only

Articles 2 and 3 of the Uniform Customs and Practice for Documentary Credits provide essential definitions and interpretations. They define a complying presentation as one that conforms to the credit terms and UCP rules. They also define a banking day as a day when the bank is open for the performance of acts subject to these rules. Force majeure is handled separately.

48. (D) 5 banking days following the day of presentation.

Article 14 of the Uniform Customs and Practice for Documentary Credits stipulates that an issuing bank or nominated bank has a maximum of five banking days to examine documents. This period begins on the day following the day of presentation. The bank must use this time to determine whether the presentation is complying and to decide whether to honor or refuse.

49. (B) II and III only

Under the Uniform Customs and Practice for Documentary Credits Article 28, insurance documents can be signed by proxies on behalf

of underwriters. The rules also clarify that any percentage specified for coverage is considered a minimum requirement. Banks will accept insurance documents containing exclusion clauses unless the credit specifically prohibits them, ensuring practical flexibility in cargo insurance coverage.

50. (C) An LC incorporating an additional undertaking by a bank other than the issuing bank to pay on receipt of complying documents. An irrevocable confirmed letter of credit involves an additional undertaking by a second bank, usually the advising bank. This bank adds its own guarantee to pay the beneficiary upon receipt of complying documents. This provides the seller with double protection, as they can rely on the creditworthiness of both the issuing bank and the confirming bank for payment settlement.

51. (A) I and II only

When banks in India issue commercial standby letters of credit for imports, they must implement specific safeguards. These include restricting the facility to independent power producers or export houses and obtaining credit reports on overseas suppliers. Furthermore, the beneficiary must provide a declaration regarding the importer's failure to perform, ensuring the instrument is used correctly for its intended purpose.

52. (D) The conversion of the foreign currency debt into Indian rupees on a set day if the bill is not retired.

Crystallisation is a banking procedure used when an importer fails to pay for a bill drawn under a letter of credit. The bank converts the outstanding foreign currency liability into Indian rupees at the prevailing exchange rate. This process fixes the amount in local currency, allowing the bank to manage its exchange risk while continuing to seek recovery from the importer.

53. (A) I, II, and III only

Crystallisation of import bills occurs when the importer does not retire the bill within a specific period. For sight bills, this is done after a maximum timeframe set by the bank's policy, or earlier if requested. Usance bills are crystallized on their due date. Banks recover interest from the date of negotiation to compensate for the used funds.

- 54.** (C) It is used when a buyer requests partial deliveries at specific intervals, covering the value of each consecutive instalment.

A revolving letter of credit is a flexible financial tool used for ongoing trade relationships involving multiple shipments. It allows the credit amount to be renewed automatically after each shipment is paid or after a specific period. This avoids the need to open a new letter of credit for every instalment, streamlining the process for buyers and sellers with regular deliveries.

- 55.** (C) I, III, and IV only

The Uniform Rules for Bank-to-Bank Reimbursements 725 provide that reimbursement authorizations must be issued via authenticated tele-transmission. A reimbursing bank is not obligated to honor a claim unless it has specifically provided a reimbursement undertaking. Furthermore, issuing banks should not require claiming banks to submit certificates of compliance to the reimbursing bank, as reimbursement is independent of the credit.

- 56.** (A) Data in a document need not be identical but must not conflict with data in any other document.

Article 14 of the Uniform Customs and Practice for Documentary Credits introduced a more flexible approach to document consistency. Data in various documents need not be identical word-for-word. Instead, the rules require that the information must not conflict with data in any other document or with the credit itself. This reduces rejections based on minor typographical or non-material differences.

- 57.** (A) I, II, III, and IV only

Banks must verify that a commercial invoice is issued by the beneficiary and made out in the name of the applicant. The description of goods must match the credit exactly, and the total value must not exceed the credit amount. Standard trade terms like FOB or CIF should be clearly stated. Countersignature by a chamber of commerce is not mandatory.

- 58.** (B) The second beneficiary has the right to further transfer the LC in favour of another third party. A transferable letter of credit allows a first beneficiary to request the nominated bank to make the credit available to one or more second

beneficiaries. However, the second beneficiary does not have the right to further transfer the credit to a third party. This restriction prevents the credit from moving through an infinite chain of intermediaries, maintaining transaction security.

- 59.** (B) I, II, III, and IV only

An insurance document must be issued and signed by the insurance company or its agent and cannot be issued by a broker. The currency of the policy must match the letter of credit currency. Claims are usually made payable in the country of the applicant. The policy must be properly endorsed to ensure the transfer of rights to the bank.

- 60.** (C) Under EXW (Ex-Works), the seller has the maximum responsibility, including loading the goods at the port of origin.

Ex-Works is the term where the seller has the minimum obligation, simply making goods available at their own premises. The buyer bears all costs and risks of loading and transport. Conversely, Delivered Duty Paid represents the maximum obligation for the seller. Under Free Carrier, buyers can instruct carriers to provide onboard notations to sellers, facilitating credit compliance.

- 61.** (A) I, II, III, and IV only

Under URR 725, authorizations must be authenticated and reimbursing banks have the right to reject amendments. Irrevocable authorizations require the reimbursing bank's agreement for changes. While claiming banks use tele-transmission, reimbursing banks typically have three banking days to process claims. A seven-day period is not the standard for claim processing under these specific reimbursement rules for banks in trade finance.

- 62.** (C) The customs clearing agent

Standard letter of credit transactions involve specific financial and commercial parties. The applicant requests the credit, the issuing bank provides the undertaking, and the advising bank communicates the credit to the seller. While a customs clearing agent may facilitate the physical movement of goods for the importer, they are not a direct party to the letter of credit contract itself.

- 63.** (C) Assertion (A) is true, but Reason (R) is false. Banks are protected under documentary credit rules because they do not assume responsibility for the genuineness of documents or the conduct of issuers. While it is true that parties deal in documents and not in goods, this principle explains the scope of bank examination rather than providing the legal reason for the disclaimer regarding document authenticity or legal effects.
- 64.** (D) The invoice value must exceed the LC value by 5% to account for exchange rate fluctuations. When examining an invoice, banks ensure it is in the applicant's name and indicates the correct sales terms like FOB or CIF. The description of goods must strictly correspond to the letter of credit. Crucially, the invoice value must not exceed the credit amount. Any requirement for the invoice to exceed the credit value by five percent is incorrect.
- 65.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
In bank-to-bank reimbursement, charges are usually for the account of the issuing bank. The reimbursement authorization is indeed independent of the underlying letter of credit. However, the independence of the authorization is not the logical reason why charges are assigned to the issuing bank; rather, it is because the issuing bank initiates the instruction for its own convenience.
- 66.** (C) FCA (Free Carrier)
The Incoterms group for Main Carriage Paid includes terms where the seller pays for the primary transport to the destination. This includes CFR, CIF, CPT, and CIP. In contrast, Free Carrier belongs to the Main Carriage Unpaid group, where the seller's responsibility ends once the goods are delivered to the carrier named by the buyer at the origin.
- 67.** (A) Green Clause
A green clause letter of credit is an extension of the red clause. It allows the seller to receive an advance payment before shipment. However, it adds a requirement for the seller to provide proof that the goods have been warehoused in the name of the bank. This provides the bank with more security than a standard red clause credit.
- 68.** (D) A Red Clause advance is paid against an undertaking, while a Green Clause also requires proof of warehousing.
Both red and green clause letters of credit provide pre-shipment finance to the seller. The primary difference lies in the documentation required. A red clause advance is typically paid against a simple undertaking to ship the goods. A green clause requires additional security in the form of documentary proof that the goods are stored in a warehouse.
- 69.** (D) Accept the documents because Article 14(i) allows documents dated prior to the date of credit.
Article 14(i) of the Uniform Customs and Practice for Documentary Credits expressly permits documents to be dated prior to the issuance date of the credit. As long as the document is presented within the validity period and meets all other terms, a commercial invoice dated before the credit is perfectly acceptable. This provides flexibility for goods prepared before the credit.
- 70.** (C) Ensure the importer offers a margin, follow due diligence, and obtain a credit report on the overseas seller.
Banks must implement robust safeguards when issuing large-value letters of credit. This includes conducting thorough due diligence on the importer and obtaining credit reports on the overseas seller to mitigate fraud risks. Requiring a margin and ensuring all regulatory documents like the bill of entry are eventually submitted are essential steps to protect the bank's financial interests and safety.
- 71.** (B) Not partial shipment, as goods are on the same means of transport and have the same journey.
According to the Uniform Customs and Practice for Documentary Credits, goods loaded on the same vessel for the same journey do not constitute a partial shipment. Even if the carrier issues multiple bills of lading with different dates, the presentation is compliant. Since all goods are on the same transport, the condition prohibiting partial shipment has not been violated.
- 72.** (A) II, IV, III, I, V
The export letter of credit process begins when the buyer requests their bank to issue the credit. The issuing bank then transmits the credit via

SWIFT to the exporter's bank. The exporter ships the goods and presents documents to their bank for negotiation. Finally, the documents are sent to the issuing bank, which delivers them to the importer.

73. (A) Monday, 11.09.2023 (Closing hours)

A bank has a maximum of five banking days following the day of presentation to examine documents and give notice of refusal. If documents are received on a Monday, the five-day period includes Tuesday through the following Monday. Therefore, the bank must send its notice of refusal by the close of business on the following Monday to remain compliant.

74. (A) P-2, Q-1, R-4, S-3

The Uniform Customs and Practice for Documentary Credits have evolved through various revisions. The 1951 version established that parties deal in documents. The 1974 revision introduced nomination. The 1983 version defined deferred payment undertakings. Finally, the 1993 revision (UCP 500) established that a credit is irrevocable by default if the document is silent. These milestones shaped modern trade finance.

75. (A) Convert the currency into rupees at the prevailing Bill Selling Rate or the forward contract rate.

During the crystallization of an import bill, the issuing bank converts the foreign currency amount into Indian rupees. This conversion is typically done at the bank's prevailing bill selling rate or the rate fixed in a forward contract. This action transfers the exchange risk to the importer and establishes a fixed rupee liability that the bank then manages.

76. (C) P-3, Q-4, R-1, S-2

The Uniform Customs and Practice for Documentary Credits 600 are organized logically. Articles 1 through 5 cover definitions and the independence of credits. Articles 6 through 10 address bank obligations and availability. Articles 19 through 27 provide rules for various transport documents. Finally, Articles 34 through 37 contain disclaimers regarding document effectiveness and force majeure events.

77. (B) No, if the LC is silent, cover must be at least 110% of CIF/CIP value, totaling USD 55,000.

Under the Uniform Customs and Practice for Documentary Credits, if a credit is silent on the insurance amount, the coverage must be at least one hundred and ten percent of the CIF or CIP value. For an invoice of fifty thousand dollars, the required cover is fifty-five thousand dollars. A policy for fifty-two thousand dollars would therefore be discrepant.

78. (A) P-2, Q-4, R-3, S-1

Incoterms are categorized by the point of delivery and responsibility. Departure includes Ex-Works. Main Carriage Unpaid includes Free Alongside Ship, where the seller delivers goods to the port. Main Carriage Paid includes Carriage Paid To, where the seller pays for transport. Arrival terms like Delivered at Place Unloaded involve the seller bearing all risks until the destination.

79. (D) The presentation on Monday is acceptable as the expiry date extends to the next business day.

The International Standby Practices 98 rule 3.13 addresses expiry dates falling on non-business days. If the last day for presentation is a day when the bank is closed, the expiry date is automatically extended to the next business day. This allows the beneficiary to present their claim on Monday if the credit expired on a Sunday, ensuring fair treatment.

80. (D) Negotiating Bank - Examines documents as per UCP and negotiates if they appear to comply on their face.

A negotiating bank plays a critical role in trade by examining documents presented by the beneficiary. If the documents appear to comply with the credit terms on their face, the bank may negotiate them, which involves purchasing the drafts or documents. This provides immediate liquidity to the seller while the bank waits for reimbursement from the issuing bank.

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CHAPTER 05

Facilities for Exporters and Importers

May/June 2016

1. An AD Bank receives export documents drawn under an LC for negotiation. Upon scrutiny, the bank finds that the shipment was made late and the Bill of Lading is not properly signed. The exporter urgently needs funds. What is an acceptable course of action for the negotiating bank to finance the exporter despite the discrepancies?
 - (A) Unilaterally amend the LC terms without the issuing bank's consent and proceed to negotiate the bill.
 - (B) Pay against an indemnity/reserve or obtain specific authority from the LC opening bank to proceed.
 - (C) Reject the documents permanently and cancel all existing credit limits assigned to the respective exporter.
 - (D) Seize the goods at the destination port and conduct a public auction to recover the funds.

Oct/Nov 2009

2. Identify the incorrect pair concerning the limits for the write-off of unrealized export bills.
 - (A) Self write-off by an exporter - Up to 5% of the Exports realized in the last calendar year.
 - (B) Self write-off by an SEZ Unit - Up to 10% of the Exports realized in the last calendar year.
 - (C) Write-off by AD Bank - Up to 10% of the Exports realized for the captioned exporter in the last calendar year.
 - (D) Self write-off by a Status Holder Exporter - Up to 15% of the Exports realized in the last calendar year.

May/June 2023

3. What is the specific term used for the financial assistance allowed to an exporter to fund the need for procurement of raw material, manufacturing, and up to the stage of packing and shipment?

- (A) Pre-Shipment Finance
- (B) Post-Shipment Export Finance
- (C) Export Bill Rediscounting
- (D) Advance against Undrawn Balances

Oct/Nov 2018

4. Consider the following statements regarding the refund of export proceeds:
 - I. ADs can allow a refund of export proceeds provided the exporter submits evidence of re-import of goods into India on account of poor quality or trade dispute.
 - II. The AD must obtain a certificate from DGFT/Customs ensuring that no incentives have been availed by the exporter or that proportionate incentives have been surrendered.Which of the above statement(s) is/are correct?
 - (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

May/June 2007

- What constitutes Buyer's Credit in international trade?
- (A) Credit directly extended by the overseas supplier of goods to the importer.
 - (B) Credit arranged by the exporter from a bank in their own country to finance the buyer.
 - (C) Credit granted by the importer's domestic bank to the overseas supplier against a Letter of Credit.
 - (D) Credit arranged by the importer from a bank or financial institution outside his country to settle the payment of imports.

Oct/Nov 2025

6. Consider the following statements regarding advance remittances for imports:
 - I. Advance remittances up to USD 200,000 can be allowed after duly satisfying about the transaction and the standing of the supplier.
 - II. For advance remittances exceeding USD

200,000, an irrevocable standby letter of credit or a guarantee from an international bank of repute is mandatory without any exception.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2012

7. What is the standard prescribed time limit within which the amount representing the full export value of goods or software must be realized and repatriated to India from the date of export?
- (A) Six months
 - (B) Nine months
 - (C) Twelve months
 - (D) Fifteen months

Oct/Nov 2014

8. Which of the following statements apply to special cases for allowing Packing Credit Advances?
- I. Packing credits can be allowed to sub-suppliers at the first stage under the Rupee credit scheme on the basis of an inland LC.
 - II. For the export of de-oiled cake, proceeds from the local sale of oil seeds can be used to liquidate PCL within 30 days.
 - III. If a commodity falls under the 'Negative Category', a special license from the competent authority is required to export it out of India.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2019

9. To open a Diamond Dollar Account (DDA), an exporter dealing in rough and polished diamonds must have a track record of at least two years. What is the minimum average export turnover required?
- (A) Rs. 1.00 crore
 - (B) Rs. 2.00 crores
 - (C) Rs. 3.00 crores
 - (D) Rs. 5.00 crores

Oct/Nov 2006

10. Which of the following data points or actions are integrated and monitored through the Export Data Processing and Monitoring System (EDPMS)?

- I. Extension of time limit for realization of export proceeds.
- II. Details of export bills written off by AD Banks.
- III. Advance remittances received for exports and old outstanding advances.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2021

11. How is the effective date of realization of a foreign currency export bill determined?
- (A) It is the date of credit in the bank's 'NOSTRO' account.
 - (B) It is the date of debit in the bank's 'VOSTRO' account.
 - (C) It is the date the export documents are presented to the negotiating bank.
 - (D) It is the date the importer makes the payment to their local bank.

Oct/Nov 2010

12. Banks are authorized to grant pre-shipment advances under the 'Running Account' facility. Which of the following conditions govern this facility?

- I. The facility may be extended provided the need for it is established to the satisfaction of the bank.
- II. The facility can only be extended to exporters whose track record is good.
- III. Letters of credit or firm orders must be produced within a reasonable period as per the bank's policy.
- IV. For commodities covered under Selective Credit Control, banks must insist on the production of firm orders within a period of one month from the date of sanction.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

May/June 2005

13. What is the primary purpose of crystallizing an overdue export bill drawn in foreign currency?
- To immediately write off the outstanding export dues against the bank's own profit and loss account.
 - To convert the exporter's uncertain foreign exchange liability into Indian rupees to restrict exposure to exchange rate fluctuations.
 - To transfer the liability from the exporter to the foreign buyer's bank through an international arbitration mechanism.
 - To extend the concessional interest rate period indefinitely until the export proceeds are realized.

Oct/Nov 2022

14. A factor provides various services under a factoring agreement. Which of the following are recognized services provided by a factor?
- Debt Administration (managing the sales ledger).
 - Credit Protection (assessing credit risk and advising clients).
 - Factor Financing (advancing up to 75% to 80% of outstanding debts).
 - Arranging physical shipment and issuing Bills of Lading on behalf of the exporter.
- Which of the above statement(s) is/are correct?
- I, II, and III only
 - I, III, and IV only
 - II, III, and IV only
 - I, II, III, and IV

May/June 2018

15. Which of the following statements accurately reflects the features of an Exchange Earners' Foreign Currency (EEFC) Account?
- It is an interest-bearing term deposit account that allows exporters to hold funds up to 5 years.
 - Balances in EEFC accounts cannot be utilized for the repayment of packing credit advances.
 - Exporters can credit up to 50% of inward payments received in foreign currency to this account.
 - No credit facilities, either fund-based or non-fund based, should be permitted against the security of balances held in EEFC accounts.

Oct/Nov 2016

16. Which of the following guidelines apply to advance remittances for imports?
- Remittance must be made direct to the overseas supplier or his bank, and not to any agent.
 - The importer must hold the exchange control copy of a valid import license and ensure goods are not on the negative list.
 - Physical import into India must be made within six months, or three years for capital goods.
 - The AD should ensure that in case of non-import, the amount of advance remittance is repatriated to India or utilized for other permissible purposes.

Which of the above statement(s) is/are correct?

- I, II, and III only
- I, III, and IV only
- II, III, and IV only
- I, II, III, and IV

May/June 2014

17. Which of the following is correct regarding raising Trade Credit in Indian Rupees (INR)?
- Trade credit can be raised for the import of all items, including gold, permissible under the Foreign Trade Policy.
 - AD Category-I banks are permitted to give guarantees in respect of trade credit for a maximum period of three years from the date of shipment.
 - Trade credit period for the import of capital goods can be up to five years from the date of shipment.
 - Roll-over or extension of trade credit can be permitted by the AD Category-I bank beyond the permissible period without RBI approval.

Oct/Nov 2007

18. Which of the following broad guidelines need to be followed during the pre-sanction appraisal of an Export Packing Credit (EPC) proposal?
- The borrower must have an Importer-Exporter Code number (IEC).
 - The borrower's name should not appear under the caution list of RBI.
 - The borrower must have a confirmed/firm export order or Letter of Credit.
 - The export credit limit should be commensurate with the expected turnover

and cost of inputs.

- V. The quantum of finance is fixed on the CIF value minus a flat 30% margin regardless of shipment mode.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
(B) I, III, IV, and V only
(C) II, III, IV, and V only
(D) I, II, III, IV, and V

May/June 2025

19. Which of the following statements regarding the reduction in invoice value of export bills is incorrect?
- (A) ADs can approve a reduction even if the exporter is currently placed on the caution list of the RBI.
- (B) ADs can approve a reduction not exceeding 25% of the invoice value if the bill has been negotiated or sent for collection.
- (C) The reduction cannot be in respect of commodities subject to minimum price restrictions (floor price).
- (D) Reduction without any percentage restriction can be allowed if the exporter has been in export business for the last three years and outstanding bills do not exceed 5% of average annual export turnover.

Oct/Nov 2019

20. Importers must submit evidence of imports to the AD bank. Which of the following statements represent correct guidelines for this process?
- I. Importers must produce the details of the Bill of Entry or Postal appraisal form under the IDPMS system.
- II. ADs must acknowledge receipt of the exchange control copy of the Bill of Entry by issuing acknowledgement slips.
- III. The Bill of Entry/summary must be preserved by the authorised dealer for Internal Auditors/RBI verification.
- IV. If evidence is not furnished within 3 months, the AD bank must rigorously follow-up for the next 3 months.
- V. Submission of a separate BEF statement continues to be mandatory despite the operationalization of IDPMS.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV only
(B) I, III, IV, and V only
(C) II, III, IV, and V only

- (D) I, II, III, IV, and V

May/June 2009

21. Which statement is incorrect regarding advance remittances for imports?
- (A) ADs can allow advance remittances up to USD 200,000 after satisfying themselves about the transaction and the standing of the supplier.
- (B) For advance remittances exceeding USD 200,000, an irrevocable standby letter of credit or a guarantee from a bank of international repute is required.
- (C) Physical import into India should be made within six months from the date of remittance, or three years in the case of capital goods.
- (D) The requirement of a bank guarantee can be waived for advance remittances up to USD 10,000,000 subject to a suitable policy approved by the bank's Board of Directors.

Oct/Nov 2011

22. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.
- Assertion (A): Export proceeds from Nepal must always be settled exclusively through the Asian Clearing Union (ACU) mechanism.
- Reason (R): Even though Nepal is one of the participating countries under the ACU mechanism, it is exempted under the ACU currency settlement arrangements.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2010

23. When examining export documents drawn under a Letter of Credit, negotiating banks often observe discrepancies. Which of the following is NOT typically listed as a commonly observed discrepancy?
- (A) Submission of documents after the expiry of the LC.

- (B) Presentation of insurance documents drawn in the same currency as the currency of the LC.
- (C) Partial shipments effected which are not authorised by the LC.
- (D) Bill of Lading not properly signed, dated, or stamped.

Oct/Nov 2024

24. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): Banks are required to crystallize or convert an exporter's foreign exchange liability into rupees if a foreign currency export bill is not realized by its due date.

Reason (R): Crystallization restricts the period of uncertain foreign currency liability for both the bank and the exporter during the time the bill remains overdue.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2017

25. Export proceeds must generally be realized in specific manners depending on the destination. All of the following rules apply to receipts for exports EXCEPT:

- (A) Receipts for exports to Nepal in free foreign exchange must be strictly routed through the ACU mechanism.
- (B) Receipts for exports to Nepal may be in Indian Rupees.
- (C) Receipts for exports to Bhutan may be in Indian Rupees.
- (D) Receipts for exports to the Islamic Republic of Iran for eligible goods may be in any freely convertible currency.

Oct/Nov 2005

26. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Examine these two

statements carefully and select the correct answer.

Assertion (A): Following the implementation of the Import Data Processing and Monitoring System (IDPMS), the submission of separate BEF statements by banks has been discontinued. Reason (R): IDPMS tracks the movement of import transactions through the banking system in real-time, making all information on submission or non-submission of Bills of Entries directly available to the regulatory authorities.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

27. What is the primary role of the Foreign Exchange Dealers Association of India (FEDAI) in the context of international trade?

- (A) Acts as an SRO with RBI to promote external sector growth and develop forex markets.
- (B) Enforces physical movement of goods across borders and issues all necessary import licenses.
- (C) Provides direct export finance to small enterprises at concessional international interest rates.
- (D) Formulates the Foreign Trade Policy while functioning under the Ministry of Commerce.

Oct/Nov 2015

28. When export bills are drawn on an acceptance basis and are not covered under a Letter of Credit, the risk of non-payment is higher. What is the most appropriate action an exporter should take to mitigate this credit risk?

- (A) Advise the buyer to remit the payment through a Diamond Dollar Account.
- (B) Obtain separate buyer-wise credit insurance policies from ECGC.
- (C) Enter into an agreement to route the transaction through the Asian Clearing Union mechanism.
- (D) Request the bank to immediately write off the bill value as a bad debt before shipment.

May/June 2013

29. A 60 days DA (Usance) bill in USD is tendered to the bank on 10.05.2022. Assuming a Normal Transit Period (NTP) of 25 days is allowed and no grace period is considered, what will be the Notional Due Date (NDD) of the bill?
- (A) 04.07.2022 (55 days)
 (B) 03.08.2022 (85 days)
 (C) 09.07.2022 (60 days)
 (D) 15.06.2022 (35 days)

Oct/Nov 2021

30. Which of the following best describes the primary function of 'Supplier's Credit' in international trade?
- (A) To allow the exporter's bank to assume the entire credit risk of the overseas buyer.
 (B) To enable the importer to obtain immediate payment from a domestic financial institution while deferring payment to the overseas supplier.
 (C) To shift the responsibility of customs clearance and freight handling entirely to the negotiating bank.
 (D) To provide the importer with a deferred payment term directly from the overseas supplier, depending on market demand and current practices.

May/June 2024

31. Which of the following represents the correct chronological order for the processing of an export declaration where the Electronic Data Interchange (EDI) system is implemented at Customs offices?
- I. Customs verifies and authenticates the declaration in form EDF.
 II. The exporter submits the EDF form in duplicate to the Commissioner of Customs.
 III. The EDF is submitted to the authorized dealer.
 IV. Customs hands over one copy of the shipping bill marked 'Exchange Control Copy' to the exporter.
- (A) II, I, IV, III
 (B) I, II, III, IV
 (C) II, IV, I, III
 (D) III, I, II, IV

Oct/Nov 2008

32. Which of the following represents the correct chronological order of a standard international factoring transaction?
- I. The export factor sends one copy of the invoice to the import factor for collection of debt.
 II. The client/exporter approaches the export factor with details of business and debtors to get factored.
 III. The export factor signs an agreement with the client, detailing terms and indicative limits.
 IV. The export factor contacts the import factor to assess the creditworthiness of the buyer and set limits.
 V. The import factor collects the debt on the due date and remits proceeds to the export factor.
- (A) II, III, IV, I, V
 (B) II, IV, III, I, V
 (C) IV, II, III, I, V
 (D) II, IV, I, III, V

May/June 2006

33. An export bill is submitted on 10.09.2021 and drawn on 30 days DA. Applying a 25 days Normal Transit Period, the Notional Due Date (NDD) is calculated as 04.11.2021. However, the documents are realized on 08.11.2021, and the funds are credited to the bank's NOSTRO account on 06.11.2021. Up to which date will the bank charge interest on the post-shipment advance?
- (A) 04.11.2021 (Notional Due Date)
 (B) 06.11.2021 (Value date of credit)
 (C) 08.11.2021 (Date of realization advice)
 (D) 10.10.2021 (End of usance period)

Oct/Nov 2017

34. Match the types of post-shipment finance in List I with their descriptions in List II.
- List I: (Types of Post-Shipment Finance)
 P. Export bills purchased/discounted
 Q. Export bills negotiated
 R. Advances against bills sent on collection
 S. Advances against exports on consignment basis
- List II: (Descriptions)
 1. Financing against documents that are drawn under a Letter of Credit and carefully scrutinized for compliance.

2. Financing where sale proceeds are remitted for the part of goods sold, and unsold goods are sent back to the exporter.
 3. Financing allowed when export credit limits are fully utilized or documents drawn under LC are discrepant.
 4. Financing against genuine trade transactions strictly drawn in terms of a firm order, where risk of non-payment is relatively higher.
- (A) P-4, Q-1, R-3, S-2
(B) P-1, Q-4, R-2, S-3
(C) P-3, Q-2, R-4, S-1
(D) P-4, Q-3, R-1, S-2

May/June 2008

35. An Indian entity operates both an export division and an import division, trading with the same overseas counterpart. The entity requests the AD bank to set-off its export receivables against import payables. Under the prescribed guidelines, which condition would invalidate this request?
- (A) Both the export and import legs took place during the same calendar year.
(B) The transaction is fully compliant with EDPMS/IDPMS rules.
(C) The entity attempts to set-off export receivables against import payables for services.
(D) The netting is done on the date of the Balance Sheet of the SEZ Unit.

Oct/Nov 2013

36. Match the specific foreign exchange accounts in List I with their distinct features in List II.
- List I: (Foreign Exchange Accounts)
P. Diamond Dollar Account
Q. EEFC Account
R. Overseas Foreign Currency Account
S. ACU Dollar Account
- List II: (Distinct Features)
1. Non-interest bearing current account where accruals must be converted to Rupees by the end of the succeeding calendar month.
 2. Account used to deposit sale proceeds from international trade fairs and must be repatriated within one month.
 3. Separate account maintained by ADs to settle export proceeds from countries like Bangladesh, Myanmar, and Sri Lanka.
 4. Exporter can maintain up to 5 such

accounts for transacting business, requiring an average turnover of Rs. 3.00 crores.

- (A) P-2, Q-1, R-4, S-3
(B) P-4, Q-1, R-2, S-3
(C) P-1, Q-4, R-3, S-2
(D) P-4, Q-3, R-2, S-1

May/June 2015

37. A Status Holder exporter receives USD 200,000 as inward payment and credits 100% of it to their EEFC Account on October 15. Assuming no approved utilization or forward commitments are made, what action must the AD bank take regarding the unutilized balance in this account?
- (A) Permit the existing balance to remain indefinitely as a non-interest bearing deposit within the account.
(B) Perform an automatic transfer of the funds into a Diamond Dollar Account by the end of the year.
(C) Convert the cumulative funds into a foreign currency term loan with a fixed maturity of three years.
(D) Convert month-end accruals into Rupees by the last day of the succeeding calendar month.

Oct/Nov 2012

38. Which of the following pairs concerning Export Declaration Forms is correctly matched?
- (A) EDF Form - Export of software in non-physical form.
(B) SOFTEX Form - Exports of physical goods through postal channels.
(C) EDF Form - Exports other than software made by all modes.
(D) SOFTEX Form - Customs clearance document for trans-shipment cargo.

May/June 2011

39. An Pharmaceutical company wants to avail an EDF waiver. Their average annual export realization during the preceding 3 licensing years is Rs. 50 Crores. Under the specific guidelines for Pharma companies, what is the maximum value up to which they can avail the EDF waiver?
- (A) Rs. 1 Crore
(B) Rs. 2 Crores
(C) Rs. 4 Crores
(D) Rs. 5 Crores

Oct/Nov 2020

40. Identify the incorrect pair regarding the prescribed methods of payment for export realization.

(A) Countries under ACU - Settlement in ACU Dollar, ACU EURO, or ACU JPY.
 (B) Exports to Nepal - Payments routed mandatorily through the ACU mechanism.
 (C) Exports to Bhutan - Receipts may be in Indian Rupees.
 (D) Other than ACU Countries - Payment in any permitted currency like US dollars, UK pound, Euro.

May/June 2022

41. An Indian manufacturer is exporting heavy machinery (capital goods) on a medium-term credit basis of 4 years. The buyer requires 100% financing against the invoice drawn without recourse, and wants to avoid routing other business through the financier. Which financing mechanism is most appropriate for this transaction?

(A) Factoring
 (B) Post-Shipment Rupee Export Credit
 (C) Pre-Shipment Credit in Foreign Currency (PCFC)
 (D) Forfaiting

Oct/Nov 2023

42. Every person/firm/company engaged in export-import trade must apply for and obtain an Importer-Exporter Code Number (IEC Number). Which authority issues this registration number?

(A) Reserve Bank of India
 (B) Directorate General of Foreign Trade
 (C) Ministry of Finance
 (D) Central Board of Indirect Taxes & Customs

May/June 2016

43. Consider the following statements regarding the set-off of export receivables against import payables:

I. Exporters are eligible to set off import bills and export bills provided both the export and the import leg take place during the same calendar year and through the same AD Bank.

II. Set-off of export receivables against goods is strictly allowed against import payables for services and vice-versa.

Which of the above statement(s) is/are correct?

(A) Only I
 (B) Only II
 (C) Both I and II
 (D) Neither I nor II

Oct/Nov 2009

44. How is forfaiting defined in the context of financing export receivables?

(A) A mechanism for financing by discounting export receivables with recourse to the exporter for a short term on a floating rate basis.
 (B) A continuing agreement to purchase book debts and administer the sales ledger on an open account basis.
 (C) A mechanism for financing by discounting export receivables without recourse to the exporter for a medium term on a fixed rate basis.
 (D) An advance granted against goods exported on a consignment basis for approval and sale abroad.

May/June 2023

45. Consider the following statements regarding advances against duty drawback:

I. Banks may grant pre-shipment advances to exporters against their duty drawback entitlements pending final sanction by Customs Authorities.

II. The advance facility against duty drawback receivables can be covered under ECGC WTPS insurance.

Which of the above statement(s) is/are correct?

(A) Only I
 (B) Only II
 (C) Both I and II
 (D) Neither I nor II

Oct/Nov 2018

46. What is the maximum amount of trade credit (supplier's or buyer's credit) per import transaction that an AD Category-I bank can approve?

(A) USD 10 million
 (B) USD 20 million
 (C) USD 50 million
 (D) USD 100 million

May/June 2007

47. Consider the following statements regarding claims against exports:

- I. The relative export proceeds must have been realized and repatriated to India.
- II. The exporter must not be on the caution list of the Reserve Bank of India.
- III. The claim must not exceed 25% of the total export turnover of the previous financial year.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2025

48. For what maximum initial period can Pre-shipment Credit in Foreign Currency (PCFC) be allowed to exporters?
- (A) 90 days
 - (B) 180 days
 - (C) 270 days
 - (D) 360 days

May/June 2012

49. Consider the following statements regarding the Export Bill Rediscounted (EBR) scheme:
- I. EBR scheme is a scheme to finance export bills in foreign currency and is equivalent to FBP/FBD under Rupee financing.
 - II. EBR can be allowed for a maximum of 180 days at LIBOR-related rates (or ARR).
 - III. The proceeds of the bill handled under EBR cannot be utilized to adjust an existing Pre-shipment Credit in Foreign Currency (PCFC).

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2014

50. Exporters may avail Export Declaration Form (EDF) waivers for specific scenarios. Under these guidelines, what is the EDF waiver limit for Status holders/SEZ Units?
- (A) Up to 2% of the average annual export realizations during the preceding 3 licensing years.
 - (B) Up to 5% of the average annual export realizations during the preceding 3 licensing years.
 - (C) Up to 8% of the average annual export

realizations during the preceding 3 licensing years.

- (D) Up to 10% of the average annual export realizations during the preceding 3 licensing years.

May/June 2019

51. With regard to the transition of the All-in-Cost Ceiling for Trade Credit from LIBOR to ARR, consider the following statements:

- I. The benchmark rate for foreign currency trade credit refers to any widely accepted interbank rate or Alternative Reference Rate (ARR) of 6-month tenor.
- II. To account for term premia, the all-in-cost ceiling for new FCY TCs was increased by 50 bps to 300 bps over the benchmark rates.
- III. The all-in-cost strictly excludes the arranger fee, upfront fee, and management fee, capturing only the interest component.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2006

52. How does the concept of Normal Transit Period (NTP) apply to calculating the Notional Due Date for demand and usance bills?
- (A) For demand bills, the NDD is the date of handling plus grace period; for usance bills, it is usance period only.
 - (B) For demand bills, the NDD is 15 days from the date of handling; for usance bills, it is usance period plus 15 days NTP.
 - (C) For demand bills, no NTP is allowed; for usance bills, a flat 30 days NTP is applied.
 - (D) For demand bills, the NDD is 25 days from the date of handling; for usance bills, it is usance period plus 25 days NTP plus any grace period.

May/June 2021

53. When an AD Bank negotiates export bills drawn under a Letter of Credit, which of the following principles apply?
- I. Documents must be scrutinized carefully against the terms and conditions of the LC before negotiation.
 - II. Compliance with the Articles of UCPDC 600 is mandatory to ensure the claim for

payment.

III. The LC issuing bank has all rights to refuse payment in case of discrepant documents.

IV. If discrepant documents are tendered, the negotiating bank cannot negotiate the documents under any circumstances, even with the authority of the LC opening bank.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2010

54. Which of the following statements correctly describes the settlement mechanism for countries under the Asian Clearing Union (ACU)?

- (A) Export proceeds from ACU member countries must always be settled exclusively in Indian Rupees.
- (B) Trade transactions with Myanmar can only be settled through the ACU mechanism and not in any other freely convertible currency.
- (C) Export proceeds from ACU countries should be settled in ACU Dollar, ACU EURO, or ACU JPY through a separate account maintained by the AD.
- (D) Nepal is a participating country under the ACU mechanism and is therefore strictly bound by ACU currency settlement arrangements.

May/June 2005

55. Identify the correct statement regarding advances against undrawn balances.

- (A) Advance against undrawn balance can be made at a concessive rate of interest for a maximum period of 90 days.
- (B) Authorized dealers can handle such bills provided the undrawn balance is subject to a maximum of 25% of the full export value.
- (C) The exporter is not required to account for or surrender the balance of the proceeds if it falls under 10% of the invoice value.
- (D) Such advances are strictly prohibited unless prior approval is obtained from the ECGC.

Oct/Nov 2022

56. Identify the incorrect statement regarding exemptions from Export Declaration Forms (EDF).

- (A) Trade samples of goods and publicity material supplied free of payment are exempted.
- (B) Gifts accompanied by a declaration by the exporter that they are not more than ten lakh rupees in value are exempted.
- (C) Personal effects of travellers, whether accompanied or unaccompanied, are exempted.
- (D) Goods imported free of cost on re-export basis are exempted.

May/June 2018

57. Identify the incorrect statement concerning the Gold Card Scheme for exporters.

- (A) The scheme is not applicable for exporters blacklisted by ECGC or having overdue bills in excess of 10% of the previous year's turnover.
- (B) Requests from card holders would be processed quickly by banks within 25 days/15 days and 7 days for fresh applications/renewal of limits and ad hoc limits, respectively.
- (C) 'In-principle' limits will be sanctioned for a period of 5 years with a provision for automatic renewal.
- (D) A stand-by limit of not less than 20% of the assessed limit may be additionally made available to facilitate urgent credit needs.

Oct/Nov 2016

58. While making an appraisal of an export credit proposal, banks must verify several pre-sanction conditions. Which of the following is NOT a stipulated pre-sanction guideline for allowing Packing Credit advances?

- (A) The borrower's name should not appear under the caution list of RBI.
- (B) The borrower should not be under the Specific Approval list of ECGC.
- (C) The borrower must maintain an active Diamond Dollar Account with the sanctioning bank.
- (D) The borrower must have the capacity to execute the order within the stipulated time.

May/June 2014

59. The AD is permitted by the RBI to grant an extension of the time limit for realization of export proceeds beyond the stipulated period.

Which of the following is NOT a condition for granting such an extension?

- (A) The export transactions covered by the invoices are not under investigation by the Enforcement Directorate.
- (B) The AD Category-I bank is satisfied that the exporter has not been able to realize export proceeds for reasons beyond his control.
- (C) The exporter submits a declaration that the export proceeds will be realized during the extended period.
- (D) The exporter submits a certificate from the importing country's customs authority confirming the delay.

Oct/Nov 2007

60. Regarding the submission of Evidence of Imports, all of the following procedures apply EXCEPT:

- (A) Importers must submit the details of Bill of Entry or Customs assessment certificate under the IDPMS system.
- (B) The Bill of Entry should be preserved by the authorised dealer and made available to Internal Auditors/RBI Inspectors.
- (C) In case an importer does not furnish evidence within 1 month of remittance, the AD should immediately report the importer to the DGFT.
- (D) For companies listed on a stock exchange with a net worth not less than Rs. 100 crore, ADs may accept a certificate from the CEO or auditor for remittances less than USD 1,000,000.

May/June 2025

61. What is the core objective of the Export Data Processing and Monitoring System (EDPMS)?

- (A) To provide a platform for foreign buyers to bid on Indian export commodities in real-time.
- (B) To monitor the daily fluctuations of currency exchange rates for the calculation of custom duty.
- (C) To act as a central clearinghouse for matching export receivables with import payables automatically.
- (D) To simplify the procedure for filing returns on a single platform and integrate export-related returns.

Oct/Nov 2019

62. Why was the Import Data Processing and Monitoring System (IDPMS) implemented by the Reserve Bank of India and Customs?

- (A) To bypass the involvement of AD banks in import transactions and allow direct remittance by importers.
- (B) To physically track the movement of cargo ships entering Indian ports and assess customs duties automatically.
- (C) To plug large information gaps by providing a common IT-based platform that facilitates efficient processing and effective monitoring of all import transactions.
- (D) To provide importers with a facility to convert their Indian Rupee loans into foreign currency trade credits seamlessly.

May/June 2009

63. Which of the following pairs correctly matches the system with its described functionality?

- (A) EDPMS - A system that tracks the movement of import transactions through the banking system and Customs.
- (B) IDPMS - A system that integrates returns related to the handling of shipping bills and delayed utilization of export advances.
- (C) IDPMS - A system where primary data on import transactions flows from Customs to the server to be shared with AD banks.
- (D) EDPMS - A system implemented exclusively for monitoring Buyer's Credit and Supplier's Credit.

Oct/Nov 2011

64. Match the regulatory/institutional bodies in List I with their primary functions in List II.

List I: (Regulatory/Institutional Bodies)

- P. Reserve Bank of India
- Q. Directorate General of Foreign Trade
- R. International Chamber of Commerce
- S. FEDAI

List II: (Primary Functions)

- 1. Formulates the Foreign Trade Policy and issues IEC numbers.
- 2. Promotes best practices in conducting Foreign Exchange business as a Self-Regulatory Organization.
- 3. Regulates the Exchange Control and receipts/payments of foreign exchange under FEMA.
- 4. Facilitates international trade through

documents like UCP 600 and Incoterms.

- (A) P-3, Q-1, R-4, S-2
- (B) P-1, Q-3, R-2, S-4
- (C) P-4, Q-2, R-1, S-3
- (D) P-3, Q-4, R-1, S-2

May/June 2010

- 65.** Match the types of international factoring in List I with their specific characteristics in List II.
List I: (Types of International Factoring)

- P. Single factor system
- Q. Two factor system
- R. Direct export factoring
- S. Direct import factoring

List II: (Specific Characteristics)

1. Only one factoring company based in the exporter's country is engaged, making all arrangements independently.
2. The exporter and importer decide to have a common factor with offices in both countries to reduce costs.
3. Only one factor based in the importer's country is engaged, primarily to facilitate the financing of debts.
4. Two different factors in two countries are used, both independently rendering services to the exporter and the importer.

- (A) P-4, Q-2, R-1, S-3
- (B) P-2, Q-4, R-1, S-3
- (C) P-1, Q-3, R-4, S-2
- (D) P-2, Q-1, R-4, S-3

Oct/Nov 2024

- 66.** Match the specific time limits in List I with their corresponding durations in List II.

List I: (Terms)

- P. Realization of export bills for warehouse exports
- Q. Submission of export documents to AD from date of export
- R. Normal Transit Period (NTP) for foreign currency export bills
- S. Maximum period to supply Evidence of Import after physical import

List II: (Durations)

1. 15 days
 2. 21 days
 3. 25 days
 4. 15 months
- (A) P-4, Q-2, R-3, S-1
 - (B) P-2, Q-4, R-1, S-3
 - (C) P-3, Q-1, R-4, S-2

- (D) P-4, Q-3, R-2, S-1

May/June 2017

- 67.** Which of the following pairs correctly matches the system with its described functionality?
- (A) EDPMS - A system that tracks the movement of import transactions through the banking system and Customs.
 - (B) IDPMS - A system that integrates returns related to the handling of shipping bills and delayed utilization of export advances.
 - (C) IDPMS - A system where primary data on import transactions flows from Customs to the server to be shared with AD banks.
 - (D) EDPMS - A system implemented exclusively for monitoring Buyer's Credit and Supplier's Credit.

Oct/Nov 2005

- 68.** What is the framework permitted for a resident importer raising Trade Credit in Indian Rupees (INR)?
- I. Trade credit can be raised for import of all permissible items except gold.
 - II. The period for import of non-capital goods can be up to one year or the operating cycle, whichever is lower.
 - III. The period for import of capital goods can be up to three years from the date of shipment.
 - IV. No roll-over or extension can be permitted by the AD Category-I bank beyond the permissible period.
 - V. The maximum amount an AD Category-I bank can permit is USD 100 mn equivalent per import transaction.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, III, IV, and V

May/June 2020

- 69.** Under certain circumstances, the AD Bank may write-off unrealized export bills without any limit at the request of the exporter. Which of the following are valid circumstances for such an action?
- I. The overseas buyer is declared insolvent, supported by a certificate from the Official Liquidator.
 - II. The unrealized amount represents the balance due where the case is settled

through an Embassy or Foreign Chambers of Commerce.

- III. The goods exported have been auctioned or destroyed by the Port/Customs/Health authorities in the importing country.
- IV. The exporter simply decides to close their business operations in the current financial year.
- V. The exporter faces severe domestic liquidity issues and requests a blanket waiver.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and V only
- (C) II, III, and IV only
- (D) I, II, III, and V

Oct/Nov 2015

70. Which of the following are salient features of the Gold Card Scheme for exporters?

- I. 'In-principle' limits are sanctioned for a period of 3 years with a provision for automatic renewal.
- II. A stand-by limit of not less than 20% of the assessed limit may be made available for urgent credit needs.
- III. Requests from card holders for fresh applications/renewal are processed within 25 days/15 days respectively.
- IV. Gold Card holders are given preference in the granting of packing credit in foreign currency.
- V. The applicable rate of interest charged will be significantly higher than the general rate to account for the premium services offered.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, III, IV, and V

May/June 2013

71. An Indian manufacturer is exporting heavy machinery (capital goods) on a medium-term credit basis of 4 years. The buyer requires 100% financing against the invoice drawn without recourse, and wants to avoid routing other business through the financier. Which financing mechanism is most appropriate for this transaction?

- (A) Factoring
- (B) Post-Shipment Rupee Export Credit
- (C) Pre-Shipment Credit in Foreign Currency

(PCFC)

(D) Forfaiting

Oct/Nov 2021

72. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): Once goods have been shipped, the bank should not continue with a pre-shipment advance against those goods but should liquidate it.

Reason (R): Liquidation of Pre-Shipment Credit (PCL) is achieved by allowing post-shipment advance to the extent of PCL against the relative export bills.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2024

73. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): Forfaiting represents a type of specialized export credit insurance rather than a direct source of finance.

Reason (R): In forfaiting, the financier purchases medium-term export claims on the buyers without recourse to the exporters.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2008

74. An exporter receives an order worth USD 100,000 on a CIF basis with shipment to be made by sea. The bank calculates the quantum of finance based on the FOB value. Assuming

the bank deducts a standard 13% to represent freight and insurance, and applies a profit margin deduction of 10% on the FOB value, what is the base value of the goods on which the final advance limit will be set before applying the margin?

- (A) USD 87,000
- (B) USD 100,000
- (C) USD 75,000
- (D) USD 78,300

May/June 2006

75. An exporter approaches the bank for Packing Credit Loan (PCL) against an export order of USD 60,000 CFR. The bill buying rate is Rs. 75.00. The bank deducts 12% for insurance and freight costs to arrive at the FOB value, and requires a 25% margin. What is the actual PCL amount allowed to the exporter?
- (A) Rs. 45,00,000
 - (B) Rs. 39,60,000
 - (C) Rs. 33,75,000
 - (D) Rs. 29,70,000

Oct/Nov 2017

76. An exporter submits documents drawn on 30 days usance (D/A) for USD 50,000 to the bank. On that day, the TT buying rate is 74.90, the Bill buying rate is 74.80, and the premium for 30 days is 5 paise. Which specific exchange rate will the bank apply for the purchase/discount of this export bill?
- (A) 74.90
 - (B) 74.80
 - (C) 74.85
 - (D) 74.95

May/June 2008

77. An exporter presents a bill to be sent on a collection basis because their export credit limits are fully utilized. The bill is a 90 days Usance bill. What is the maximum period for which the bank can charge a concessional rate of interest for this advance against a collection bill?
- (A) Transit period + Usance period + grace period (if any)
 - (B) Transit period only
 - (C) Usance period only
 - (D) Flat 180 days irrespective of bill tenor

Oct/Nov 2013

78. An exporter availed a Packing Credit Loan (PCL) for a specific export order, but the actual exports for that order did not take place due to order cancellation. The exporter recently realized proceeds from another export transaction against which no packing credit was availed. How can the bank handle the existing PCL?
- (A) The existing PCL may be liquidated with the export proceeds of the other transaction, provided no packing credit was availed against those proceeds.
 - (B) The PCL must immediately be converted into a long-term commercial loan at double the domestic penal rate.
 - (C) The bank must report the exporter to the ECGC and write off the PCL amount.
 - (D) The PCL cannot be liquidated with proceeds from a different order and must be settled in cash by the exporter.

May/June 2015

79. An exporter classified as an SEZ Unit realized total exports of Rs. 10 Crores in the last calendar year. They have some outstanding export dues that they wish to self-write-off despite their best efforts to realize them. What is the maximum absolute amount they can self-write-off for these unrealized bills?
- (A) Rs. 50 Lakhs
 - (B) Rs. 1 Crore
 - (C) Rs. 1.5 Crores
 - (D) Rs. 2 Crores

Oct/Nov 2012

80. An Indian manufacturer is exporting heavy machinery (capital goods) on a medium-term credit basis of 4 years. The buyer requires 100% financing against the invoice drawn without recourse, and wants to avoid routing other business through the financier. Which financing mechanism is most appropriate for this transaction?
- (A) Factoring
 - (B) Post-Shipment Rupee Export Credit
 - (C) Pre-Shipment Credit in Foreign Currency (PCFC)
 - (D) Forfaiting

ANSWERS

1. (B) Pay against an indemnity/reserve or obtain specific authority from the LC opening bank to proceed.
When export documents under a Letter of Credit contain discrepancies like late shipment or improper signing, the negotiating bank cannot claim payment from the issuing bank. To provide funds, the bank may pay against an indemnity or reserve from the exporter or seek express permission from the opening bank to waive the discrepancies. This ensures the exporter receives immediate funding.
2. (D) Self write-off by a Status Holder Exporter - Up to 15% of the Exports realized in the last calendar year.
Regulatory guidelines specify limits for the self-write-off of unrealized export bills based on realizations from the previous calendar year. Status Holder exporters are permitted a self-write-off limit of up to ten percent of their realized export value. A limit of fifteen percent is incorrect under current FEMA regulations governing the write-off procedures for authorized dealer banks and specific exporter categories.
3. (A) Pre-Shipment Finance
Pre-shipment finance, also known as packing credit, is a credit facility extended to exporters to fund the purchase of raw materials, manufacturing costs, and processing. This financial assistance covers the entire production cycle until the goods are actually shipped. It ensures the exporter has sufficient working capital to fulfill orders before receiving payment from the foreign buyer for the goods.
4. (C) Both I and II
Authorized dealers are permitted to allow the refund of export proceeds when goods are re-imported due to quality issues or trade disputes. However, the bank must ensure that the exporter has not retained any export incentives or has surrendered them proportionately. This requires verification through certificates issued by regulatory authorities like the Directorate General of Foreign Trade or the Customs department.
5. (D) Credit arranged by the importer from a bank or financial institution outside his country to settle the payment of imports.
Buyer's credit refers to a financial arrangement where an importer arranges credit from a financial institution or bank located outside their own country. This credit is used to settle the payment for the import of goods or services. It allows the importer to pay the overseas supplier immediately while repaying the loan over a specified period to the foreign financial institution.
6. (A) Only I
Authorized Dealers can allow advance remittances up to two hundred thousand dollars after verifying the transaction and the supplier's standing. While larger amounts often require a bank guarantee or standby letter of credit, exceptions exist. Therefore, the claim that these securities are mandatory for all amounts exceeding the threshold without any exception is incorrect under the existing operational guidelines for imports.
7. (B) Nine months
Under the current foreign exchange management regulations in India, the full value of exported goods or software must be realized and repatriated to the country within nine months from the date of shipment. This time limit is standardized to ensure timely inflow of foreign exchange earnings, although extensions may be granted by authorized dealers or the central bank under specific circumstances.
8. (A) I and II only
Packing credit can be extended to sub-suppliers at the initial stage based on an inland letter of credit under the rupee credit scheme. For specific commodities like de-oiled cake, proceeds from local sales of oil seeds can be used to settle the packing credit within thirty days. Both provisions help streamline the financing process for complex export production chains and suppliers.

9. (C) Rs. 3.00 crores
Exporters dealing in rough or polished diamonds who wish to maintain a Diamond Dollar Account must meet specific eligibility criteria. These include a minimum track record of at least two years in the diamond trade. Furthermore, the exporter is required to have achieved a minimum average annual export turnover of three crore rupees during the preceding three licensing years for eligibility.
10. (D) I, II, and III
The Export Data Processing and Monitoring System is a comprehensive platform designed to track and manage the lifecycle of export transactions. It monitors various activities, including the extension of realization periods, the write-off of unrealized bills by banks, and the tracking of advance remittances received. This integrated approach ensures better regulatory oversight and streamlines reporting for all export-related data and movements.
11. (A) It is the date of credit in the bank's 'NOSTRO' account.
In international trade transactions, the effective date for the realization of a foreign currency export bill is determined by the point when funds are actually available to the bank. Specifically, it is the date on which the bank's Nostro account is credited. This date is used for calculating interest, determining currency conversion rates, and ensuring compliance with regulatory realization timelines.
12. (D) I, II, III, and IV
The running account facility for pre-shipment advances is available to exporters with a good track record when the need for it is established. Exporters must produce letters of credit or firm orders within a reasonable timeframe. For commodities under selective credit control, firm orders must be presented within one month of sanction to ensure the funds are used appropriately for exports.
13. (B) To convert the exporter's uncertain foreign exchange liability into Indian rupees to restrict exposure to exchange rate fluctuations.
Crystallization is the process of converting an overdue foreign currency export bill into local currency. Its primary purpose is to stop the accumulation of exchange rate risk for the bank and the exporter. By fixing the liability in Indian rupees at the prevailing exchange rate, the uncertainty regarding future fluctuations in the foreign currency value is effectively eliminated and managed for both.
14. (A) I, II, and III only
Factoring companies provide essential financial and administrative services, including managing the sales ledger and debt administration. They also offer credit protection by assessing buyer risks and provide financing by advancing a significant portion of the outstanding debt. However, arranging physical shipment of goods and issuing transport documents like Bills of Lading are typically logistics functions, not standard services provided by factoring companies.
15. (D) No credit facilities, either fund-based or non-fund based, should be permitted against the security of balances held in EEFC accounts.
The Exchange Earners' Foreign Currency account is a non-interest-bearing facility that allows exporters to retain a portion of their foreign exchange earnings. A critical regulatory restriction on these accounts is that banks are not permitted to grant any credit facilities, whether fund-based or non-fund-based, against the security of the balances held within them. This ensures the account remains a liquidity tool.
16. (D) I, II, III, and IV
Guidelines for advance import remittances require payments to be made directly to suppliers and mandate physical import within specified timeframes. Importers must hold valid licenses and ensure goods are not restricted. If imports do not occur, the remitted funds must be repatriated or utilized for other approved purposes. These measures ensure that foreign exchange is used legitimately for actual trade and activities.
17. (B) AD Category-I banks are permitted to give guarantees in respect of trade credit for a maximum period of three years from the date of shipment.
Authorized Dealer Category-I banks are permitted to issue bank guarantees or letters of comfort for trade credits raised in Indian Rupees. This facility is available for a maximum period of three years from the date of shipment. Such

guarantees facilitate trade by providing security to overseas lenders while ensuring that the credit terms remain within the prescribed regulatory framework for all imports.

18. (A) I, II, III, and IV only

During the pre-sanction appraisal for export packing credit, banks must verify the exporter's IEC number and check the RBI caution list. A firm order or letter of credit is essential to establish the basis for finance. While credit limits must align with expected turnover, using a flat thirty percent margin regardless of the shipment mode is not a standard regulatory requirement.

19. (A) ADs can approve a reduction even if the exporter is currently placed on the caution list of the RBI.

Authorized Dealers have the authority to approve reductions in the invoice value of export bills under specific conditions, such as for trade disputes or quality issues. However, this approval is generally not granted if the exporter is currently placed on the caution list of the Reserve Bank of India. Such restrictions are in place to ensure compliance and prevent potential regulatory misuse.

20. (A) I, II, III, and IV only

Importers are required to submit proof of import, such as the Bill of Entry, through the integrated IDPMS system. Banks must acknowledge these documents and preserve them for audit purposes. While rigorous follow-up is necessary if evidence is delayed, the requirement for a separate manual BEF statement has been superseded by the digital reporting mechanisms established under the modern monitoring system.

21. (D) The requirement of a bank guarantee can be waived for advance remittances up to USD 10,000,000 subject to a suitable policy approved by the bank's Board of Directors.

While Authorized Dealers can allow advance remittances for imports, they must follow strict limits and security requirements. For amounts exceeding two hundred thousand dollars, a bank guarantee or standby letter of credit is typically required. However, the claim that this guarantee requirement can be waived for amounts as high as ten million dollars based solely on internal bank policy is incorrect.

22. (D) Assertion (A) is false, but Reason (R) is true. Although Nepal is a member of the Asian Clearing Union, it is specifically exempted from the mandatory ACU currency settlement arrangements. This means that trade transactions with Nepal do not have to be settled exclusively through the ACU mechanism. Therefore, while the reason provided for the exemption is accurate, the assertion that all settlements must go through the ACU is false.

23. (B) Presentation of insurance documents drawn in the same currency as the currency of the LC. Common discrepancies in export documents include late presentation, expired letters of credit, unauthorized partial shipments, and improperly signed bills of lading. However, presenting insurance documents drawn in the same currency as the letter of credit is a standard requirement for compliance. This would not be considered a discrepancy but rather a sign that the documents are correctly aligned with the terms.

24. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Banks convert overdue foreign currency export bills into Indian rupees through crystallization to limit the duration of exposure to exchange rate movements. This process provides certainty to both the exporter and the bank by fixing the liability at a known rate. Since the reason accurately explains the purpose and benefit of the action described in the assertion, both statements are true.

25. (A) Receipts for exports to Nepal in free foreign exchange must be strictly routed through the ACU mechanism.

Export proceeds from Nepal and Bhutan can be received in Indian Rupees. While the Asian Clearing Union manages settlements for member countries, Nepal is exempted from the mandatory ACU mechanism for receipts in free foreign exchange. Therefore, insisting that all free foreign exchange receipts for exports to Nepal must be routed strictly through the ACU is an incorrect application of rules.

- 26.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The implementation of the Import Data Processing and Monitoring System has streamlined the tracking of import transactions. Because the system provides real-time digital data to regulatory authorities regarding the submission of Bills of Entry, the old requirement for banks to submit separate manual BEF statements is no longer necessary. The reason provided correctly explains why the assertion regarding discontinuation is true.

- 27.** (A) Acts as an SRO with RBI to promote external sector growth and develop forex markets.

The Foreign Exchange Dealers Association of India serves as a self-regulatory organization that works closely with the Reserve Bank of India. Its primary role is to establish rules and guidelines for conducting foreign exchange business among member banks. By developing market practices and ensuring standardized procedures, it contributes to the orderly growth and development of the foreign exchange markets.

- 28.** (B) Obtain separate buyer-wise credit insurance policies from ECGC.

When export bills are drawn on an acceptance basis without the protection of a Letter of Credit, the exporter faces a significant risk of non-payment. To mitigate this credit risk, the most effective action is to obtain credit insurance policies from the Export Credit Guarantee Corporation. These policies protect the exporter against potential defaults by foreign buyers due to commercial reasons.

- 29.** (B) 03.08.2022 (85 days)

To calculate the Notional Due Date for a usance bill, one must add the usance period and the normal transit period to the date the bill was tendered. For a sixty-day usance bill with a twenty-five-day transit period submitted on May tenth, the total period is eighty-five days. Counting eighty-five days from the submission date results in a notional due date of August third.

- 30.** (D) To provide the importer with a deferred payment term directly from the overseas supplier,

depending on market demand and current practices.

Supplier's credit is a trade financing arrangement where the overseas exporter directly provides a deferred payment term to the importer. This allows the importer to receive goods now and pay for them at a later date as agreed in the commercial contract. The availability and duration of such credit often depend on prevailing market practices and the competitive relationship between buyer and seller.

- 31.** (A) II, I, IV, III

In an EDI-enabled customs environment, the exporter first submits the export declaration form in duplicate. Customs then verifies and authenticates the information provided. Once processed, the customs authorities hand over the exchange control copy of the shipping bill to the exporter. Finally, the exporter submits this authenticated document along with other trade papers to their authorized dealer bank for further processing.

- 32.** (B) II, IV, III, I, V

An international factoring transaction begins with the exporter approaching a factor with business details. The export factor then coordinates with an import factor in the buyer's country to assess creditworthiness and set limits. Once the assessment is positive, the export factor signs a formal agreement with the exporter. Subsequently, invoices are sent for collection, and the import factor eventually remits proceeds.

- 33.** (B) 06.11.2021 (Value date of credit)

When a post-shipment advance is provided, the bank charges interest until the funds are effectively realized. The date of realization is defined as the value date on which the proceeds are credited to the bank's Nostro account. Even if a notional due date was calculated or the realization advice was received later, the actual credit date determines the end of interest.

- 34.** (A) P-4, Q-1, R-3, S-2

Post-shipment finance varies based on document type and risk. Bills purchased involve genuine trade orders with higher risks, while negotiated bills are drawn under letters of credit and strictly scrutinized. Advances against collection are used when credit limits are full or documents are

discrepant. Consignment financing is unique as it involves selling goods abroad and remitting proceeds only after sales occur.

35. (C) The entity attempts to set-off export receivables against import payables for services. Exporters and importers are permitted to set off export receivables against import payables under specific conditions. Attempting to set off receivables from goods against payables for services is permitted under the current regulatory framework, provided the transactions involve the same overseas party and are handled by the same bank.
36. (B) P-4, Q-1, R-2, S-3
Foreign exchange accounts serve distinct purposes in international trade. The Diamond Dollar Account is for diamond traders with specific turnover requirements. EEFC accounts allow earners to hold foreign currency without interest for a short period. Overseas Foreign Currency Accounts are used for specific events like international trade fairs. ACU Dollar accounts are specialized mechanisms maintained by banks to settle trade.
37. (D) Convert month-end accruals into Rupees by the last day of the succeeding calendar month. According to the regulations governing EEFC accounts, funds cannot be held indefinitely in foreign currency. At the end of each month, any unutilized balance in the account must be monitored. The authorized dealer bank is required to convert the cumulative accruals from the previous month into Indian Rupees by the last working day of the succeeding calendar month, unless utilized.
38. (C) EDF Form - Exports other than software made by all modes.
The Export Declaration Form (EDF) is the primary document used for declaring the export of physical goods made by all modes, including sea, air, and land, but excluding software. In contrast, the SOFTEX form is specifically designed for the declaration and monitoring of software exports, whether they are shipped in physical media or transmitted through non-physical, electronic means to buyers.

39. (B) Rs. 2 Crores
Pharmaceutical companies are granted higher limits for EDF waivers to facilitate the export of free samples for clinical trials and other purposes. For a company with a high average annual export realization, the waiver limit is capped at a specific value. Under current guidelines, the maximum value for such a waiver for pharmaceutical companies is two crore rupees during a licensing year.
40. (B) Exports to Nepal - Payments routed mandatorily through the ACU mechanism.
While trade with most countries under the Asian Clearing Union must be settled through the ACU mechanism, Nepal is an exception. Payments for exports to Nepal are not mandatorily required to be routed through the ACU mechanism and can be settled in Indian Rupees. Therefore, stating that all exports to Nepal must be routed strictly through the ACU is a regulatory inaccuracy.
41. (D) Forfaiting
Forfaiting is the most suitable mechanism for financing the export of heavy machinery on medium-term credit. It allows the exporter to receive immediate payment by discounting the receivables without recourse. This means the financier assumes all credit risks. Since forfaiting is transaction-specific, it does not require the exporter to route their other business through the financier, providing flexibility for large exports.
42. (B) Directorate General of Foreign Trade
The Importer-Exporter Code is a mandatory registration number for any person or entity engaged in the import or export of goods and services from India. This unique identification number is issued by the Directorate General of Foreign Trade, which operates under the Ministry of Commerce and Industry. It serves as a primary requirement for customs clearance and foreign exchange transactions.
43. (A) Only I
Exporters are permitted to set off their import bills against export bills if both transactions occur with the same entity and are handled by the same bank. However, current regulations allow the set-off of receivables and payables for both goods and services. Therefore, while the bank must be the same, the provision for cross-sectoral set-offs

is permitted, although it was restricted under previous regulatory frameworks.

- 44.** (C) A mechanism for financing by discounting export receivables without recourse to the exporter for a medium term on a fixed rate basis. Forfaiting is a specialized trade finance mechanism where an exporter sells their medium-to-long-term receivables to a financial institution at a discount. A key feature of this arrangement is that the financing is provided on a “without recourse” basis, meaning the exporter is not liable if the buyer defaults. It typically involves fixed interest rates and is used for financing capital goods.

- 45.** (B) Only II
Banks provide advances to exporters against their expected duty drawback entitlements from the government. This facility helps bridge the liquidity gap while the final claim is being processed by customs. To protect the bank’s interest, these advances can be covered under the Whole Turnover Post-shipment insurance provided by the Export Credit Guarantee Corporation, ensuring the bank is protected against potential defaults.

- 46.** (C) USD 50 million
Under the current regulatory framework for trade credits, Authorized Dealer Category-I banks are empowered to approve both buyer’s and supplier’s credit for imports. The maximum amount that a bank can approve per individual import transaction for oil and gas refinery companies is fifty million dollars or its equivalent, whereas for others the limit is twenty million dollars. This limit ensures that significant trade volumes can be financed efficiently while maintaining oversight through the banking system’s approval.

- 47.** (A) I and II only
When an exporter makes a claim against an export transaction, certain conditions must be met for approval. The original export proceeds must have been realized and brought back to India, and the exporter should not be on the RBI caution list. These requirements ensure that claims are only processed for legitimate and completed transactions where the exporter maintains a good regulatory standing.

- 48.** (B) 180 days
Pre-shipment Credit in Foreign Currency is a facility that allows exporters to access funds at international interest rates. The initial period for which this credit is granted is typically capped at one hundred and eighty days. If needed, extensions may be allowed based on the nature of the export order, but the standard initial duration is set to align with production cycles.

- 49.** (A) I and II only
The Export Bill Rediscounted scheme provides foreign currency financing for export bills, similar to discounting rupee bills. It is available for a maximum of one hundred and eighty days at rates linked to international benchmarks. Crucially, the proceeds from these bills can be used to settle an existing pre-shipment credit in foreign currency, providing a seamless transition between the two.

- 50.** (A) Up to 2% of the average annual export realizations during the preceding 3 licensing years.
Status holders and SEZ units are entitled to higher thresholds for the waiver of Export Declaration Forms to facilitate their trade operations. The current limit allows these entities to avail an EDF waiver for a value up to two percent of their average annual export realizations over the preceding three licensing years. This facility reduces the administrative burden for major export-oriented units.

- 51.** (A) I and II only
Following the transition from LIBOR, the benchmark for trade credit interest is now based on Alternative Reference Rates or other widely accepted interbank rates. To account for the differences in these rates, the all-in-cost ceiling for new foreign currency trade credits was adjusted. This ceiling covers all costs including interest and various fees, ensuring that the total credit remains regulated.

- 52.** (D) For demand bills, the NDD is 25 days from the date of handling; for usance bills, it is usance period plus 25 days NTP plus any grace period.
The Notional Due Date is a critical date used by banks to track when an export bill is expected to be realized. For demand bills, the NDD is calculated by adding a twenty-five-day normal

transit period to the date the bank handles the documents. For usance bills, the NDD includes the usance period, the twenty-five-day transit period, and any applicable grace periods.

53. (A) I, II, and III only

When negotiating documents under a Letter of Credit, banks must adhere strictly to the terms of the credit and the international standards set by UCPDC 600. The issuing bank reserves the right to reject payments if the documents are discrepant. However, if discrepancies are found, the negotiating bank may still proceed if they obtain specific authorization from the issuing bank first.

54. (C) Export proceeds from ACU countries should be settled in ACU Dollar, ACU EURO, or ACU JPY through a separate account maintained by the AD.

Trade transactions between member countries of the Asian Clearing Union must be settled using the specialized ACU mechanism. Authorized dealers maintain separate accounts for this purpose, and payments are typically denominated in ACU Dollar, ACU Euro, or ACU JPY. This system facilitates regional trade by streamlining the clearing and settlement process for transactions among participating countries in the Asian region.

55. (A) Advance against undrawn balance can be made at a concessive rate of interest for a maximum period of 90 days.

In some export contracts, a small portion of the invoice value remains undrawn until final weights or quality are confirmed. Banks can provide advances against these undrawn balances at a concessional interest rate for a period not exceeding ninety days. The maximum permissible undrawn balance that can be handled by an authorized dealer is generally limited to ten percent of value.

56. (B) Gifts accompanied by a declaration by the exporter that they are not more than ten lakh rupees in value are exempted.

While several categories are exempt from filing an Export Declaration Form, the exemption for gifts is subject to specific value limits. Currently, gifts must be accompanied by a declaration that their value does not exceed five lakh rupees to be

exempt. Stating that the limit is ten lakh rupees is incorrect, as it exceeds the threshold prescribed by prevailing export regulations.

57. (C) 'In-principle' limits will be sanctioned for a period of 5 years with a provision for automatic renewal.

The Gold Card Scheme provides several benefits to eligible exporters, including quicker processing times and stand-by limits for urgent needs. However, the 'in-principle' credit limits under this scheme are typically sanctioned for a duration of three years. Stating that these limits are sanctioned for five years is incorrect, as it does not align with the standard three-year term set by guidelines.

58. (C) The borrower must maintain an active Diamond Dollar Account with the sanctioning bank.

Pre-sanction appraisal for Packing Credit involves checking the exporter's IEC, ensuring they are not on the RBI caution list, and confirming they have the capacity to fulfill the order. While an exporter may choose to have a Diamond Dollar Account, maintaining one with the specific sanctioning bank is not a mandatory regulatory requirement for the approval of a Packing Credit advance.

59. (D) The exporter submits a certificate from the importing country's customs authority confirming the delay.

Authorized dealers can grant extensions for realizing export proceeds if the delay is beyond the exporter's control and no investigation is pending. The exporter must also declare that the funds will be realized within the new timeframe. However, obtaining a certificate from the importing country's customs authority is not a standard requirement for an authorized dealer to approve such an extension.

60. (C) In case an importer does not furnish evidence within 1 month of remittance, the AD should immediately report the importer to the DGFT.

Importers are required to submit evidence of import, and banks must preserve these records and follow up on delays. For large listed companies, a certificate from the CEO or auditor may be accepted for certain remittances. However, if an importer fails to provide evidence within one month, the bank does not immediately report

them to the DGFT; instead, standard follow-up occurs.

- 61.** (D) To simplify the procedure for filing returns on a single platform and integrate export-related returns.

The primary goal of the Export Data Processing and Monitoring System is to provide an integrated digital platform for the tracking of all export-related data. It simplifies the process of filing various returns and allows for the seamless monitoring of shipping bills and export realizations. By centralizing this information, the system enhances the efficiency of both the banking sector and authorities.

- 62.** (C) To plug large information gaps by providing a common IT-based platform that facilitates efficient processing and effective monitoring of all import transactions.

The Import Data Processing and Monitoring System was introduced to create a unified IT-based platform for managing import transactions. It allows for the real-time tracking of the movement of funds and goods by sharing data between Customs, the Reserve Bank, and commercial banks. This system effectively plugs information gaps and ensures that all import-related remittances are matched with physical imports.

- 63.** (C) IDPMS - A system where primary data on import transactions flows from Customs to the server to be shared with AD banks.

The Import Data Processing and Monitoring System functions by receiving primary data regarding import transactions directly from the Customs department server. This information is then shared with authorized dealer banks through the platform. This electronic flow of data ensures that banks can verify the legitimacy of remittances against the actual physical entry of goods as recorded by the customs authorities.

- 64.** (A) P-3, Q-1, R-4, S-2

International trade is governed by various bodies with specific roles. The Reserve Bank of India manages foreign exchange controls, while the Directorate General of Foreign Trade formulates trade policies. The International Chamber of Commerce provides standardized rules like UCP 600. FEDAI, acting as a self-regulatory

organization, ensures that foreign exchange dealers follow consistent and professional practices in the Indian market.

- 65.** (B) P-2, Q-4, R-1, S-3

Factoring arrangements can involve different configurations of factors. A two-factor system utilizes independent factors in both the exporter's and the importer's countries to manage the transaction. In contrast, a single-factor system or direct factoring involves only one factor performing all necessary tasks. These different models allow businesses to choose the most efficient way to manage and finance their receivables.

- 66.** (A) P-4, Q-2, R-3, S-1

Specific durations govern various stages of the export and import process. Export documents must be submitted within twenty-one days of shipment, while the normal transit period for foreign currency bills is twenty-five days. Realization of proceeds for warehouse exports is allowed up to fifteen months. These timeframes, including the fifteen-day limit for certain import evidence, ensure timely reporting and settlement.

- 67.** (C) IDPMS - A system where primary data on import transactions flows from Customs to the server to be shared with AD banks.

The Import Data Processing and Monitoring System serves as a vital link between customs and the banking industry. Primary data regarding all import transactions is transmitted from the customs server to a central platform, which is then accessed by authorized dealer banks. This mechanism facilitates the efficient monitoring of import payments and ensures they are accurately matched with goods.

- 68.** (A) I, II, III, and IV only

Resident importers can raise trade credit in Indian Rupees for most items, with specific periods set for capital and non-capital goods. While Authorized Dealer banks can approve significant amounts per transaction, they are generally not permitted to grant extensions or roll-overs beyond the allowed period on their own. These rules maintain a disciplined approach to short-term external liabilities.

69. (A) I, II, and III only

Authorized Dealers may write off unrealized export bills without a limit under extreme circumstances, such as the buyer's insolvency or the destruction of goods by authorities. Cases settled through embassies or foreign chambers are also eligible. However, internal business closures or general liquidity issues faced by the exporter are not considered valid grounds for an unlimited write-off of outstanding export receivables.

70. (A) I, II, III, and IV only

The Gold Card Scheme offers several advantages, such as prioritized processing for credit applications and stand-by limits for urgent requirements. It also provides preferences for packing credit in foreign currency. However, it is important to note that the interest rates for these cardholders are intended to be competitive or concessional, rather than being set higher than standard market rates.

71. (D) Forfaiting

Forfaiting is the ideal solution for exporters of capital goods who require medium-term financing on a non-recourse basis. By selling the receivables to a forfaiter, the exporter receives immediate cash and eliminates the risk of buyer default. Since this is a specialized, one-off transaction, the exporter does not need to move their entire banking relationship to the forfaiting institution.

72. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Once goods are shipped, the pre-shipment credit must be closed. This is normally done by converting the pre-shipment loan into a post-shipment advance, such as by purchasing or discounting the resulting export bills. Although both statements correctly describe the actions and the relationship between the two types of finance, they represent distinct steps in the financing cycle for exports.

73. (D) Assertion (A) is false, but Reason (R) is true.

Forfaiting is fundamentally a method of trade financing, not a type of insurance policy. It involves the actual purchase of export receivables, providing the exporter with immediate cash flow.

While it does remove the risk of non-payment from the exporter, it is a financial transaction. Therefore, the reason correctly describes the mechanism of forfaiting, while the assertion mischaracterizes its nature.

74. (A) USD 87,000

To determine the base value for setting a credit limit on a CIF order, the bank first converts the value to FOB by deducting freight and insurance. In this case, thirteen percent is deducted from the one hundred thousand dollar CIF value, resulting in eighty-seven thousand dollars. This FOB value then serves as the starting point before any further profit margins are considered.

75. (D) Rs. 29,70,000

Starting with a CFR value of sixty thousand dollars, the bank first deducts twelve percent for costs to reach an FOB value of fifty-two thousand eight hundred dollars. Converting this at the seventy-five-rupee rate gives three million nine hundred and sixty thousand rupees. Applying a twenty-five percent margin (retaining seventy-five percent) results in a final packing credit of twenty-nine lakh seventy thousand rupees.

76. (C) 74.85

When a bank purchases or discounts a usance export bill, it applies the bill buying rate. This rate is derived from the TT buying rate by accounting for various factors. For a thirty-day bill, any applicable premium for the usance period is added to the bill buying rate. Therefore, adding a five-paise premium to a base bill buying rate of 74.80 results in 74.85.

77. (A) Transit period + Usance period + grace period (if any)

For advances against export bills sent on a collection basis, the period for which concessional interest is charged depends on the total time the funds are expected to be outstanding. This duration is calculated by summing the normal transit period, the usance period of the bill, and any grace period allowed in the buyer's country, ensuring the exporter receives support throughout.

78. (A) The existing PCL may be liquidated with the export proceeds of the other transaction,

provided no packing credit was availed against those proceeds.

If an export order is cancelled after a packing credit loan has been availed, the exporter may be allowed to settle the outstanding debt using proceeds from a different export transaction. This is permitted provided that no other packing credit was already taken against those specific proceeds. This flexibility helps exporters manage their liabilities when faced with unforeseen changes in their orders.

79. (B) Rs. 1 Crore

SEZ units are permitted a self-write-off limit for unrealized export bills of up to ten percent of their total export realizations from the previous calendar year. For a unit that realized ten crore rupees last year, this ten percent limit translates to a maximum absolute amount of one crore rupees. This allowance provides SEZ exporters with a mechanism to manage uncollectible debts.

80. (D) Forfaiting

Forfaiting is specifically designed to facilitate the export of high-value capital goods on medium-to-long-term credit. It provides the exporter with immediate payment while the forfaiter takes on the buyer's credit risk without any recourse. Because the financing is tied to the specific transaction, it allows the exporter to maintain their existing banking relationships elsewhere, making it a flexible financial tool.

NODIA

CHAPTER 06

External Commercial Borrowings and Foreign Investments in India

Oct/Nov 2018

1. Subsequently, the PROI increases their holding in the listed Indian company to 12%, classifying it as FDI. After two years, a new equity issuance dilutes their holding back down to 9%. How should the investment be treated now?
(A) It must be immediately reclassified as FPI since it is below 10%.
(B) It shall continue to be treated as FDI, as “Once an FDI, always an FDI.”
(C) The PROI must sell the 9% holding in the open market.
(D) It must be converted into Foreign Currency Exchangeable Bonds.

May/June 2025

2. What is the most appropriate statement regarding the use of an Escrow account under the transfer of non-debt instruments?
(A) It is strictly prohibited under all circumstances.
(B) It can only be used for repatriating dividends.
(C) It is permitted for the transfer of equity instruments between a resident and a non-resident.
(D) It is mandatory for all transactions involving Non-Resident to Non-Resident transfers.

Oct/Nov 2011

3. Which of the following defines a Foreign Currency (FCY) Denominated ECB?
(A) Borrowings in freely convertible foreign currencies, including bank loans, floating/fixed rate notes, and trade credits.
(B) Borrowings raised exclusively in Indian Rupees but indexed to a freely convertible foreign currency to mitigate risks.
(C) Plain Vanilla Rupee denominated bonds issued overseas and placed privately to access international liquidity pools.
(D) Equity investments made by a Person Resident Outside India on a repatriable

basis through the direct entry route.

May/June 2012

4. Arrange the following steps in the correct chronological order for the Process of Reporting on the Foreign Investment Reporting and Management System (FIRMS) - Entity Master:
I. Entity User receives password via mail from autoreply.
II. RBI office validates the Entity User.
III. Fill New Entity User Reg. Form.
IV. Fill in the Entity Details using the provided/changed password.
Which of the above sequences is correct?
(A) III, II, I, IV
(B) III, I, II, IV
(C) II, III, I, IV
(D) I, II, III, IV

Oct/Nov 2024

5. Read the following statements regarding INR Denominated ECBs:
I. It includes Plain Vanilla Rupee denominated bonds issued overseas which can be either placed privately or listed on exchanges.
II. It includes fully and compulsorily convertible instruments and trade credits up to 1 year.
Which of the above statements is/are correct?
(A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

May/June 2016

6. Arrange the following steps in the correct chronological order for the Process of Reporting on FIRMS - SMF Business User:
I. Ensure Entity Master is available.
II. Fill New Business User Reg. Form.
III. AD Bank selected validates the Business User form and approves/rejects the same.

IV. Business User receives password via mail from autoreply.

Which of the above sequences is correct?

- (A) II, I, III, IV
- (B) I, II, III, IV
- (C) I, III, II, IV
- (D) II, III, I, IV

Oct/Nov 2007

7. Which of the following entities is incorrectly identified as an eligible borrower for ECBs?

- (A) SIDBI
- (B) Unregistered partnerships engaged in local retail trade
- (C) EXIM Bank
- (D) Units in Special Economic Zones (SEZ)

May/June 2005

8. Match the Foreign Investment Reporting Form in List I with its designated Timeframe in List II.

List I: (Foreign Investment Reporting Form)

- P. FC-GPR
- Q. LLP (I)
- R. FLA
- S. FC-TRS

List II: (Designated Timeframe)

- 1. Within 30 days from the date of issue of capital instruments
 - 2. On or before the 15th of July
 - 3. Within 60 days of transfer of capital instruments
 - 4. Within 30 days from the date of receipt of funds/contribution
- (A) P-2, Q-3, R-1, S-4
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-4, Q-2, R-3, S-1

Oct/Nov 2020

9. For which of the following activities can ECB proceeds be utilized, representing an exception to the general negative list?

- (A) Working capital purposes when raised from a foreign equity holder
- (B) Investment in the domestic capital market
- (C) Real estate activities involving buying and selling of land
- (D) On-lending to entities for equity investment

May/June 2021

10. Which of the following reporting forms is incorrectly paired with its purpose?

(A) LLP (I) - LLP receiving amount of consideration for capital contribution

(B) Form InVi - An Indian company making downstream investment in another Indian company

(C) ESOP - Stock option to persons resident outside India

(D) DRR - Reporting of issue/transfer of depository receipt

Oct/Nov 2014

11. What is the Minimum Average Maturity Period (MAMP) for manufacturing sector companies raising ECBs up to USD 50 million or its equivalent per financial year?

- (A) 1 year
- (B) 3 years
- (C) 5 years
- (D) 10 years

May/June 2019

12. What is the maximum limit for the Late Submission Fee (LSF) for delayed reporting of foreign investment?

- (A) INR 10 lakhs or 300% of amount involved (whichever is lower)
- (B) The amount involved in the delayed reporting or 100% of the amount involved
- (C) INR 5 lakhs or 100% of amount involved (whichever is lower)
- (D) Flat fee of INR 10 lakhs regardless of amount

Oct/Nov 2009

13. Within how many working days from the close of the month to which it relates must borrowers report actual ECB transactions in Form ECB 2 to reach the RBI?

- (A) 3 working days
- (B) 5 working days
- (C) 7 working days
- (D) 15 working days

May/June 2023

14. Which of the following NDI Rules is incorrectly paired with its subject matter?

- (A) Rule 9 - Transfer of equity instruments of an Indian company by or to a PROI
- (B) Rule 21 - Pricing guidelines
- (C) Rule 10 - Investments by FVCI
- (D) Rule 23 - Downstream investments

Oct/Nov 2016

15. Read the following statements reflecting the All-in-Cost ceilings and inclusions for ECBs:
- For new ECBs, the ceiling is Benchmark rate plus 500 bps spread.
 - For INR denominated ECBs, the ceiling is Benchmark rate plus 450 bps spread.
 - All-in-cost includes rate of interest, other fees, guarantee fees, and ECA charges.
 - All-in-cost includes commitment fees and withholding tax payable in INR.
 - In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread.
- Which of the above statement(s) is/are correct?
- I, II, IV and V only
 - II, III, IV and V only
 - I, III, IV and V only
 - I, II, III and V only

May/June 2007

16. Which document is NOT part of the illustrative list for obtention of Foreign Investments?
- Copy of MOU/share purchase agreement or declaration that there is no such agreement
 - Scan email acknowledgement received by investee company from FIRMS helpdesk w.r.t Entity master
 - NOC from joint account holder if shares are being issued on single name
 - FIRC in original obtained and endorsed and retained

Oct/Nov 2025

17. Which of the following is NOT included in the All-in-Cost for ECBs?
- Guarantee fees
 - Commitment fees
 - ECA charges
 - Expenses and other fees paid in foreign currency

May/June 2014

18. Which of the following statements incorrectly describes a requirement for the Refund of Foreign Investments?
- The branch has to intimate RBI about the refund once the refund transaction is processed.
 - FIRC in original must be obtained, endorsed, and retained along with the records.
 - A letter confirming that a 5% interest

element is included in the refund of the excess share application funds.

- The Board resolution must confirm that the identified excess funds are being repatriated back to the original foreign investor.

Oct/Nov 2019

19. What is the most appropriate requirement for an ECB borrower regarding financial hedges?
- The borrower must cover both principal and coupon through financial hedges from the time liability is created.
 - The borrower is required to cover only the principal amount through financial hedges starting from the final repayment date.
 - The borrower is entirely exempted from financial hedging if the ECB is raised specifically from a direct foreign equity holder.
 - Hedging is only mandatory for high-value transactions where the ECB exceeds USD 750 million per financial year.

May/June 2009

20. Identify the correct statement regarding Foreign Currency Convertible Bonds (FCCBs).
- FCCBs are strictly issued as purely domestic instruments and cannot be converted into ordinary shares.
 - FCCBs must inherently contain a mandate for physical real estate backing in the host country.
 - The issue related expenses for FCCBs are allowed to exceed 10% of the issue size.
 - Issuance of FCCBs shall conform to applicable regulations and must be issued without any warrants attached.

Oct/Nov 2010

21. The following question consists of two statements, one labeled as 'Assertion (A)' and the other as 'Reason (R)'. Examine these two statements carefully and select the correct answer.
- Assertion (A): ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to the Borrower's Rupee accounts with AD Category I banks in India.
- Reason (R): Until utilization of ECB proceeds, funds can be invested in liquid assets such as Treasury bills of one-year maturity having minimum specified ratings.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2010

22. "Zenith Manufacturing Ltd.," a company in the manufacturing sector, plans to raise an ECB of USD 45 million in the current financial year to import capital goods. What is the Minimum Average Maturity Period (MAMP) applicable to this transaction?
- (A) 1 year
 - (B) 3 years
 - (C) 5 years
 - (D) 10 years

Oct/Nov 2022

23. The following question consists of two statements, one labeled as 'Assertion (A)' and the other as 'Reason (R)'. Examine these two statements carefully and select the correct answer.

Assertion (A): Any draw-down in respect of an ECB should take place only after obtaining the Loan Registration Number (LRN).

Reason (R): The LRN is issued by the Authorized Dealer Category I Bank without forwarding the application to the RBI.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2018

24. "Zenith Manufacturing Ltd." decides to park the unutilized ECB proceeds in term deposits with an AD Category I bank in India. What is the regulatory constraint on this parking?
- (A) It can be parked for up to 12 months cumulatively and must be kept in an unencumbered position.
 - (B) It can be parked for a maximum period of 6 months cumulatively and must be kept in a

strictly encumbered position.

- (C) The proceeds must be instantly utilized within 15 days; otherwise, term deposits are not allowed.
- (D) The funds can only be invested in Treasury bills of five-year maturity issued by the government.

Oct/Nov 2006

25. Read the following statements regarding the refinancing of existing ECBs:

- I. Refinancing of existing ECB by fresh ECB is permitted provided the outstanding maturity of the original borrowing is not reduced.
- II. The all-in-cost of the fresh ECB must be lower than the all-in-cost of the existing ECB.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2017

26. Based on its Startup recognition, "BioNext" intends to raise an ECB under the Automatic Route. What is the maximum amount it can raise per financial year?

- (A) USD 1 million or equivalent
- (B) USD 3 million or equivalent
- (C) USD 50 million or equivalent
- (D) USD 750 million or equivalent

Oct/Nov 2005

27. In the context of Foreign Investments, how is a "Fully diluted basis" defined?

- (A) The total number of shares that would be outstanding if all possible sources of conversion are exercised.
- (B) The exact number of equity shares currently trading on the recognized stock exchange.
- (C) The proportion of shares held exclusively by Persons Resident Outside India.
- (D) The net valuation of the company's equity capital after deducting statutory liabilities.

May/June 2020

28. "Omega Corp" raises an FCY denominated ECB from its direct foreign equity holder. The proceeds will be utilized for general corporate

purposes. What is the MAMP applicable to this specific ECB?

- (A) 1 year
- (B) 3 years
- (C) 5 years
- (D) 7 years

Oct/Nov 2015

29. What constitutes a Foreign Portfolio Investment (FPI)?

- (A) Any investment in equity instruments made by a Person Resident Outside India on a non-repatriable basis.
- (B) Investment by a PROI in less than 10% of the paid-up equity capital of a listed company on a fully diluted basis.
- (C) Investment made by a PROI in 10% or more of the paid-up equity capital of a listed company to establish significant control.
- (D) Direct capital contribution in an LLP by a foreign entity.

May/June 2013

30. The ECB raised by "Omega Corp" is a new borrowing linked to an Alternative Reference Rate (ARR). What is the All-in-Cost ceiling applicable to this ECB?

- (A) Benchmark rate plus 450 bps spread
- (B) Benchmark rate plus 500 bps spread
- (C) Benchmark rate plus 550 bps spread
- (D) Fixed rate of 10% irrespective of benchmark

Oct/Nov 2021

31. Which is the best description of a "Sectoral Cap" in the context of foreign investments?

- (A) The minimum guaranteed dividend percentage payable to foreign portfolio investors.
- (B) The maximum number of foreign employees an investee company can hire.
- (C) The absolute limit on the total amount of external commercial borrowings a registered startup can raise per financial year.
- (D) The ceiling limit for PROI subscription to the paid-up capital of an Indian company as prescribed on a sector-wise basis.

May/June 2024

32. In the transaction between the NR and the Resident, within what timeframe must the reporting form be filed?

- (A) Within 30 days from the date of issue of

capital instruments to ensure compliance with sectoral reporting rules.

- (B) Within 60 days of instrument transfer or receipt of funds, whichever occurs earlier.
- (C) On or before the 15th of July of the current year for the completion of the annual reporting cycle.
- (D) Within 12 months from the date of the mutual agreement established between the buyer and the seller.

Oct/Nov 2008

33. Read the following conditions and determine which must be met for an entity to be recognized as a Start-up company under DPIIT norms:

- I. Start-up recognition is valid for up to 10 years from incorporation/registration.
- II. Turnover for any financial year since incorporation does not exceed INR 100 crores.
- III. The entity is working towards innovation, development or improvement of products/processes.
- IV. The entity is a private company, registered partnership firm, or LLP.
- V. The entity is permitted to issue convertible notes repayable within 10 years from the date of issue.

Which of the above statement(s) is/are correct?

- (A) I, II, IV and V only
- (B) I, II, III and IV only
- (C) II, III, IV and V only
- (D) I, II, III, IV and V

May/June 2006

34. "Pioneer Infra Ltd." failed to file its Annual Return of Foreign Liabilities and Assets (FLA) on time and is calculating its Late Submission Fee (LSF). What was the due date for filing the FLA?

- (A) On or before the 15th of April
- (B) On or before the 15th of July
- (C) Within 30 days from the close of the financial year
- (D) Within 60 days of the receipt of funds

Oct/Nov 2017

35. Which of the following is NOT listed as an Eligible Investee Entity for foreign investment?

- (A) Unregistered sole proprietorship firms
- (B) Indian companies as defined under the Companies Act 2013

NODIA

- (C) Trusts being Venture Capital Funds regulated by SEBI
- (D) Special Investment Vehicles

May/June 2008

36. What is the maximum cap on the LSF that "Pioneer Infra Ltd." could be liable to pay for its delayed reporting?
- (A) 100% of the amount involved in the delayed reporting
 - (B) INR 1Cr or 300% of the amount involved (whichever is lower)
 - (C) A fixed penalty of INR 50,000
 - (D) INR 5 lakhs or 50% of amount involved

Oct/Nov 2013

37. Identify the correct pair regarding the upfront consideration required for specific eligible investment instruments.
- (A) Partly paid Equity shares – 10% upfront
 - (B) Share warrants – 25% upfront
 - (C) Convertible notes – 50% upfront
 - (D) Bonus shares – 15% upfront

May/June 2015

38. To proceed with the refinancing, how must the all-in-cost of the fresh ECB compare to the existing ECB?
- (A) The all-in-cost of the fresh ECB must be strictly equal to the existing ECB.
 - (B) The all-in-cost of the fresh ECB can be higher by a maximum of 100 bps.
 - (C) The all-in-cost of the fresh ECB must be lower than the all-in-cost of the existing ECB.
 - (D) There are no restrictions on the all-in-cost during refinancing.

Oct/Nov 2012

39. Real Estate Business is prohibited from receiving foreign investments. Which of the following is NOT classified as part of the prohibited "Real Estate Business"?
- (A) Buying and selling of commercial properties for the purpose of earning rental income or capital appreciation.
 - (B) Purchase and long-term leasing of industrial land intended for new project modernization.
 - (C) Construction of Farm Houses for residential or commercial use within designated agricultural zones.

- (D) Trading in Transferable Development Rights as part of standardized real estate market operations.

May/June 2011

40. A Person Resident Outside India (PROI) purchases equity shares equivalent to 8% of the paid-up equity capital on a fully diluted basis in a listed Indian company. How should this investment be classified?
- (A) Foreign Portfolio Investment (FPI)
 - (B) Foreign Direct Investment (FDI)
 - (C) Downstream Investment
 - (D) Foreign Venture Capital Investment (FVCI)

Oct/Nov 2023

41. The following question consists of two statements, one labeled as 'Assertion (A)' and the other as 'Reason (R)'. Examine these two statements carefully and select the correct answer.
- Assertion (A): A person resident outside India holding equity instruments in an Indian Company may pledge them in favor of an Overseas Bank to secure credit facilities extended to a PROI.
- Reason (R): The loan proceeds from the overseas bank must result in an immediate capital inflow into India.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2022

42. What is the basic objective of External Commercial Borrowings (ECBs) for Indian entities?
- (A) To replace domestic capital entirely with foreign capital intended for short-term trade financing purposes.
 - (B) To supplement domestic capital for creation of capital assets within capital account management frameworks.
 - (C) To strictly regulate and minimize the inflow of foreign currency to ensure the stability of the Indian Rupee.
 - (D) To provide exclusive funding for real estate

and capital market investments in the domestic Indian market.

Oct/Nov 2018

43. In the context of the transfer of non-debt instruments, which statement correctly identifies the pricing guidelines and reporting requirement for a transfer via "Sale" from a Non-Resident (NR) to a Resident (R)?
- (A) Pricing Guidelines: Yes; Reporting: FCTRS
 - (B) Pricing Guidelines: NA; Reporting: NA
 - (C) Pricing Guidelines: Yes; Reporting: FC-GPR
 - (D) Pricing Guidelines: NA; Reporting: FCTRS

May/June 2025

44. How does the Automatic Route for raising ECBs fundamentally differ from the Approval Route?
- (A) Under the Automatic Route, prospective borrowers must obtain direct clearance from the Ministry of Finance, whereas the Approval Route requires RBI authorization.
 - (B) The Automatic Route permits borrowing without any examination, while the Approval Route involves strict scrutiny by SEBI.
 - (C) Cases are examined by AD Category I banks under the Automatic Route, while the Approval Route requires direct RBI authorization.
 - (D) The Automatic Route is restricted to INR Denominated ECBs for specific sectors, while the Approval Route is for FCY Denominated ECBs.

Oct/Nov 2011

45. Read the following statements regarding Entity Master creation in the FIRMS system:
- I. Entity master creation is independent of AD Bank.
 - II. One entity can have multiple Entity users simultaneously.
 - III. Entity user named in Authorization Letter himself/herself cannot sign the same.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) I and III only
 - (C) II and III only
 - (D) I, II and III

May/June 2012

46. Which of the following statements regarding eligible borrowers for ECBs is correct?

NODIA

- (A) Port Trusts and Units in Special Economic Zones (SEZ) are prohibited from raising ECBs due to their specific regulatory status.
- (B) All entities eligible to receive FDI are only permitted to raise INR ECBs to maintain the stability of the domestic currency.
- (C) Registered micro-finance entities, such as Not-for-Profit Companies, are permitted to raise only INR denominated ECBs.
- (D) Entities recognized as a Startup by the Central Government are currently unable to raise ECBs through any of the available routes.

Oct/Nov 2024

47. Read the following statements describing the rules for Single Master Form (SMF) Business User creation:
- I. Business User creation can happen only if Entity Master is in place.
 - II. Ensure correct IFSC code of the bank is available.
 - III. Authority letter for Business User is the same as that for Entity Master.
 - IV. Board Resolution is not required for Business User creation.
 - V. For any resolution in Business User creation, entity has to contact the concerned bank.
- Which of the above statement(s) is/are correct?
- (A) I, II, III and IV only
 - (B) II, III, IV and V only
 - (C) I, III, IV and V only
 - (D) I, II, IV and V only

May/June 2016

48. Read the following activities and determine which are included in the negative list for which ECB proceeds cannot be utilized:
- I. Real estate activities
 - II. Investment in capital market
 - III. Equity investment
 - IV. Working capital purposes except from foreign equity holder
 - V. Repayment of Rupee loans except from foreign equity holder
- Which of the above statement(s) is/are correct?
- (A) I, II, III and V only
 - (B) II, III, IV and V only
 - (C) I, III, IV and V only
 - (D) I, II, III, IV and V

Oct/Nov 2007

49. Match the Foreign Investment Form in List I with its Purpose in List II.

List I: (Foreign Investment Form)

- P. Form DI
- Q. Form InVi
- R. Form Convertible Notes (CN)
- S. Depository Receipt Return (DRR)

List II: (Purpose)

- 1. Reporting of issue/transfer of depository receipt
- 2. Investment vehicle which has issued its unit to person resident outside India
- 3. Issuance & Transfer of CNs by Indian startup company
- 4. Indian company making downstream investment in another Indian company

- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

May/June 2005

50. Read the following statements describing Recognized Lenders for ECBs:

- I. The lender should be a resident of a FATF or IOSCO compliant country.
- II. Multilateral and Regional Financial Institutions where India is a member country are considered recognized lenders.
- III. Individuals are unconditionally permitted to act as lenders for all types of ECBs.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II and III

Oct/Nov 2020

51. Identify the correct pair regarding the Late submission fee (LSF) scale based on the amount involved in reporting.

- (A) Up to INR 1Cr – 0.15%
- (B) More than INR 1Cr – 0.05%
- (C) Up to INR 1Cr – 0.05%
- (D) More than INR 1Cr – 0.50%

May/June 2021

52. The following question consists of two statements, one labeled as 'Assertion (A)' and the other as 'Reason (R)'. Examine these two

statements carefully and select the correct answer.

Assertion (A): Foreign branches and subsidiaries of Indian banks are permitted as recognized lenders only for FCY ECBs.

Reason (R): Underwriting by foreign branches and subsidiaries of Indian banks for issuances by Indian banks will not be allowed.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2014

53. Match the Non-Debt Instruments (NDI) Rule in List I with its description in List II.

List I: (Non-Debt Instruments (NDI) Rule)

- P. Rule 4
- Q. Rule 3
- R. Rule 8
- S. Rule 5

List II: (Description)

- 1. Restrictions on investments in India by PROI
- 2. Permission for making investment by a PROI
- 3. Restrictions on receiving investments
- 4. Issue of ESOPs & SWEAT Equity shares

- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

May/June 2019

54. Match the ECB utilization scenario in List I with the corresponding Minimum Average Maturity Period (MAMP) in List II.

List I: (ECB Utilization Scenario)

- P. General corporate purposes from a foreign equity holder
- Q. Manufacturing sector raising up to USD 50 million
- R. Startups
- S. Repayment of Rupee loans availed domestically for capex

List II: (Minimum Average Maturity Period)

- 1. 3 years
- 2. 5 years

3. 1 year
4. 7 years
- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2009

55. Read the following list of documents and identify which are required for the obtention of Foreign Investments:

- I. Application (for Inward) along with FEMA declaration signed by Investee Company.
- II. Brief profile of Investee Company providing main business activities with 5-digit NIC code.
- III. Copy of MOA of Indian Investee Company.
- IV. 6 Point KYC SWIFT of the remitter/investor as per RBI format.

Which of the above statement(s) is/are correct?

- (A) I, II and III only
- (B) I, II, III and IV
- (C) II, III and IV only
- (D) I, III and IV only

May/June 2023

56. The following question consists of two statements, one labeled as 'Assertion (A)' and the other as 'Reason (R)'. Examine these two statements carefully and select the correct answer.

Assertion (A): In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread.

Reason (R): All-in-cost for ECBs comprehensively includes commitment fees and withholding tax payable in INR to ensure accurate pricing.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2016

57. Read the following list of documents and identify which are required for the Refund of Foreign Investments:

- I. Application (FCTRS Outward) + Form A2 signed by Investee Company.

- II. Copy of UIN letter / FIRMS FCGPR reporting Ref Number.
- III. Letter from the Company mentioning reason for return of funds.
- IV. Board resolution confirming excess funds have been received as share application money.

Which of the above statement(s) is/are correct?

- (A) I, II, III and IV
- (B) I, II and III only
- (C) II, III and IV only
- (D) I, III and IV only

May/June 2007

58. Read the following statements regarding ECB Operational Concepts:

- I. Change of currency from one freely convertible foreign currency to INR is freely permitted.
- II. All eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the Automatic Route.
- III. Issuance of any type of guarantee by Indian banks relating to ECB is strictly permitted.
- IV. The financial hedge for all exposures on account of ECB should start from the time liability is created in the books.

Which of the above statement(s) is/are correct?

- (A) I, III and IV only
- (B) I, II and IV only
- (C) II, III and IV only
- (D) I, II, III and IV

Oct/Nov 2025

59. Read the following statements regarding the definition of "Real Estate Business" under FEMA NDI Rules:

- I. Real estate business does not include brokerage services in relation to buying/selling of real estate.
- II. Real estate business does not include the development of townships and construction of residential/commercial premises.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

NODIA

May/June 2014

60. Which statement incorrectly describes the operational guidelines for changes in ECB parameters?
- (A) Changes should be in consonance with ECB norms.
- (B) Reduced repayment by mutual agreement should be reported to the RBI.
- (C) Changes must be reported through revised Form ECB not later than 7 days from the changes effected.
- (D) While submitting the revised Form ECB, changes should be specifically mentioned in the communication.

Oct/Nov 2019

61. Conceptually, what defines an “indirect equity holder” under the Foreign Equity Holder criteria for ECBs?
- (A) A holder with a minimum direct equity holding of 25% in the borrowing entity.
- (B) A holder with a minimum indirect equity holding of 51%.
- (C) Any group company holding at least 10% equity with no common overseas parent.
- (D) A portfolio investor holding exactly 5% of paid-up capital on a fully diluted basis.

May/June 2009

62. “Zenith Manufacturing Ltd.” is exploring options to borrow the ECB from a regional financial institution based overseas. Under the ECB guidelines, can this institution be considered a recognized lender?
- (A) No, only foreign equity holders are permitted as recognized lenders.
- (B) No, regional financial institutions are strictly prohibited from lending to manufacturing companies.
- (C) Yes, but only if the institution is registered directly with SEBI as an FPI.
- (D) Yes, provided India is a member country of that Multilateral or Regional Financial Institution.

Oct/Nov 2010

63. “BioNext”, a bio-technology company incorporated 8 years ago, was recognized as a Startup by the Central Government. The company’s turnover has never exceeded INR 100 crores. Is BioNext eligible to be treated

as a “Start-up company” to receive foreign investment?

- (A) No, because start-up recognition is strictly restricted to 7 years from incorporation for all sectors.
- (B) Yes, because in the case of a recognized startup, the period is valid up to 10 years.
- (C) No, because turnover must exceed INR 100 crores to qualify.
- (D) Yes, but only if it raises funds exclusively through Foreign Currency Convertible Bonds.

May/June 2010

64. Read the following statements regarding the Late Submission Fees (LSF) for ECB reporting delays:
- I. LSF can be paid for a period of delay ranging from up to 30 days to beyond 3 years from the due date of submission.
 - II. Late submission fees may range from Rs. 5,000 to Rs. 1,00,000 per year depending on the length of the delay.
 - III. Payment of LSF is restricted only to borrowers operating under the Approval Route.
- Which of the above statement(s) is/are correct?
- (A) II and III only
- (B) I and III only
- (C) I, II and III
- (D) I and II only

Oct/Nov 2022

65. For the ECB raised by “BioNext” as a recognized startup, what will be the applicable Minimum Average Maturity Period (MAMP)?
- (A) 1 year
- (B) 3 years
- (C) 5 years
- (D) 10 years

May/June 2018

66. Read the following statements regarding the conversion of ECB into Equity:
- I. The activity of the borrowing company must be covered under the automatic route of FDI.
 - II. Conversion can be executed without the lender’s consent provided there is no additional cost.
- Which of the above statement(s) is/are correct?
- (A) Only I

- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2006

67. Since “Omega Corp” is raising the FCY denominated ECB from its direct foreign equity holder under the automatic route, what is the maximum permissible ECB liability-equity ratio?
- (A) 3:1
 - (B) 4:1
 - (C) 5:1
 - (D) 7:1

May/June 2017

68. What is the most appropriate regulatory treatment if an existing investment by a PROI in equity instruments of a listed Indian company falls to a level below 10 percent of the post issue paid-up equity capital on a fully diluted basis?
- (A) It must be immediately reclassified and reported as a Foreign Portfolio Investment.
 - (B) The investor is mandated to divest the remaining shares within a 60-day window to comply with sectoral investment caps.
 - (C) The shares must be compulsorily converted into unlisted equity.
 - (D) The investment continues as FDI, following the regulatory principle of “Once an FDI, always an FDI.”

Oct/Nov 2005

69. Which of the following defines Downstream Investments (Indirect Foreign Investments)?
- (A) Strategic investment by a resident Indian citizen in overseas capital markets to diversify their personal financial portfolio.
 - (B) Remittances sent by NRIs for maintenance of relatives in India.
 - (C) Investments by an Indian entity, which is not owned or controlled by resident Indians, into the equity of another Indian company.
 - (D) Investment by a domestic venture capital fund exclusively in registered startups.

May/June 2020

70. Match the Investment Vehicle in List I with its corresponding SEBI Regulation in List II.
- List I: (Investment Vehicle)
- P. Alternative Investment Funds (AIFs)
- Q. Foreign Portfolio Investors (FPI)

- R. Infrastructure Investment Trusts (InvITs)
- S. Real Estate Investment Trusts (REITs)

List II: (SEBI Regulation)

- 1. SEBI (InvITs) Regulations, 2014
- 2. SEBI (AIFs) Regulations, 2012
- 3. SEBI (FPI) Regulations, 2019
- 4. SEBI (REITs) Regulations, 2014
- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2015

71. A Non-Resident (NR) investor wishes to sell shares of an unlisted Indian company to a Resident (R) in India. Which form must be utilized to report this transfer of non-debt instruments?
- (A) FC-GPR
 - (B) FCTRS
 - (C) Form DI
 - (D) FLA

May/June 2013

72. Which of the following is incorrectly paired regarding Eligible Foreign Investors?
- (A) PROI - Non resident entities, NRIs, OCIs, Foreign Nationals
 - (B) Erstwhile OCBs - Who are under the RBI caution list
 - (C) NRIs resident in Nepal and Bhutan - Subject to inward remittances received in free foreign exchange
 - (D) Foreign Portfolio Investors - Registered in accordance with SEBI Regulations

Oct/Nov 2021

73. According to the operational guidelines for the transfer of non-debt instruments, whose responsibility is it to ensure the reporting of the sale from the Non-Resident (NR) to the Resident (R)?
- (A) The Non-Resident Transferor
 - (B) The Resident Transferee
 - (C) The AD Category I Bank exclusively
 - (D) The domestic custodian

May/June 2024

74. Read the following statements regarding Eligible Investment Instruments:
- I. Fully paid Equity shares
 - II. Partly paid Equity shares, provided 25% of

total consideration is received upfront and balance within 12 months

- III. Fully, Compulsorily and mandatorily convertible debentures
- IV. Share warrants provided at least 25% of consideration is received upfront
- V. Convertible notes issued by Startup entities, repayable or converted within a period not exceeding 10 years

Which of the above statement(s) is/are correct?

- (A) I, III, IV and V only
- (B) II, III, IV and V only
- (C) I, II, III, IV and V
- (D) I, II, III and V only

Oct/Nov 2008

75. The amount involved in "Pioneer Infra Ltd."s delayed reporting is INR 80 Lakhs. According to the LSF current scale, what percentage is applicable to calculate the variable component of the fee per year?
- (A) 0.05%
 - (B) 0.10%
 - (C) 0.15%
 - (D) 0.25%

May/June 2006

76. Read the following list and identify which combination represents sectors prohibited from receiving foreign investments:
- I. Lottery business including Government, Private and On-line
 - II. Chit Funds and Nidhi Business
 - III. Manufacturing of Tobacco, Cigarettes & tobacco substitutes
 - IV. Development of industrial parks and integrated townships
- Which of the above statement(s) is/are correct?
- (A) I, II and IV only
 - (B) II, III and IV only
 - (C) I, II and III only
 - (D) I, III and IV only

Oct/Nov 2017

77. "Alpha Logistics", an Indian corporate, wishes to refinance its existing ECB by raising a fresh ECB. Under what condition is this refinancing permitted regarding outstanding maturity?
- (A) The outstanding maturity of the original borrowing can be reduced by up to 50%.
 - (B) The outstanding maturity of the original borrowing must not be reduced.

- (C) The new ECB must have a fixed maturity of exactly 10 years regardless of the original.
- (D) Refinancing is only permitted if the original maturity has already expired.

May/June 2008

78. Read the following conditions governing the pledge of shares by a person resident outside India in favor of a Bank in India:
- I. To secure credit facilities being extended to such Indian company.
 - II. For genuine business purposes.
 - III. Submission of a declaration/annual certificate from the statutory auditor of the investee company that loan proceeds will be utilized for the said purpose.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II and III

Oct/Nov 2013

79. "Alpha Logistics" intends to use a foreign branch of an Indian bank to participate in the refinancing of its existing ECB. Is this permitted?
- (A) No, foreign branches of Indian banks are restricted from participating in refinancing due to systemic risk policies.
 - (B) Yes, it is permitted unconditionally for all types of borrowers and all sectors.
 - (C) Yes, but only for INR denominated ECBs raised from the same parent lender.
 - (D) Permitted only if the borrower is a highly rated corporate or a Maharatna/Navratna Public Sector Undertaking.

May/June 2015

80. The following question consists of two statements, one labeled as 'Assertion (A)' and the other as 'Reason (R)'. Examine these two statements carefully and select the correct answer.
- Assertion (A): A person resident outside India holding equity instruments in an Indian Company may pledge them in favor of an Overseas Bank to secure credit facilities extended to a PROI.
- Reason (R): The loan proceeds from the overseas bank must result in an immediate capital inflow into India.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

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ANSWERS

1. (B) It shall continue to be treated as FDI, as “Once an FDI, always an FDI.”

The regulatory principle governing foreign investment in India stipulates that once an investment is classified as Foreign Direct Investment, it continues to be treated as such regardless of subsequent dilution. Even if the holding falls below the ten percent threshold in a listed company, the status remains unchanged for reporting and compliance purposes under FEMA rules.

2. (C) It is permitted for the transfer of equity instruments between a resident and a non-resident.

Escrow accounts are specifically permitted for the transfer of equity instruments between a resident and a person resident outside India. This mechanism facilitates the smooth settlement of share transfers by holding the consideration amount until the fulfillment of agreed conditions. It provides security for both parties involved in the transaction while ensuring compliance with foreign exchange regulations.

3. (A) Borrowings in freely convertible foreign currencies, including bank loans, floating/fixed rate notes, and trade credits.

Foreign Currency denominated External Commercial Borrowings consist of loans raised in freely convertible foreign currencies. These include bank loans, floating or fixed rate notes, bonds, debentures, and trade credits. Such borrowings are essential for Indian entities to access international capital markets, allowing them to fund long-term requirements while managing currency risks through appropriate hedging strategies.

4. (A) III, II, I, IV

The process for reporting on the Foreign Investment Reporting and Management System begins with filling the New Entity User Registration Form. Subsequently, the Reserve Bank of India office validates the entity user. Once validated, the user receives a password via an automated email. Finally, the user fills in the

detailed entity information using the provided or updated password.

5. (A) Only I

Indian Rupee denominated External Commercial Borrowings include plain vanilla bonds issued overseas, which may be placed privately or listed on international exchanges. However, fully and compulsorily convertible instruments are classified as foreign direct investment rather than commercial debt. Trade credits for one year are also distinct from the standardized rupee-denominated borrowing framework applicable to long-term capital requirements.

6. (B) I, II, III, IV

Creating a Business User on the Single Master Form platform requires the Entity Master to be available first. The next step involves filling the New Business User Registration Form. Following this, the selected Authorized Dealer Bank validates and either approves or rejects the application. Upon successful approval, the Business User receives an automated password via email for system access.

7. (B) Unregistered partnerships engaged in local retail trade

Eligible borrowers for External Commercial Borrowings include entities allowed to receive foreign direct investment, such as registered companies, Port Trusts, and Special Economic Zone units. Unregistered partnerships and entities engaged in local retail trade do not meet the criteria for raising foreign debt. This restriction ensures that only legally recognized and regulated businesses access international credit markets under FEMA.

8. (B) P-1, Q-4, R-2, S-3

Reporting requirements vary by investment type. The FC-GPR form must be filed within thirty days of issuing capital instruments. For Limited Liability Partnerships, the LLP(I) form is required within thirty days of receiving funds. The Annual Return of Foreign Liabilities and Assets is due by

July fifteenth. Finally, the FC-TRS form for share transfers is filed within sixty days.

9. (A) Working capital purposes when raised from a foreign equity holder

While general working capital needs are usually on the negative list for debt proceeds, an exception exists for borrowings from a direct foreign equity holder. This allows Indian companies to fund operational requirements through international loans provided the lender maintains a significant equity stake. Other restricted uses include real estate trading, domestic capital market investments, and on-lending activities.

10. (B) Form InVi - An Indian company making downstream investment in another Indian company

Form InVi is designated for reporting units issued by investment vehicles to persons resident outside India. In contrast, downstream investments made by an Indian company into another Indian company are reported using Form DI. Correct reporting is vital for tracking indirect foreign investment levels and ensuring that sectoral caps are maintained across the various layers of corporate holding structures.

11. (A) 1 year

Manufacturing sector companies raising External Commercial Borrowings up to fifty million dollars per financial year benefit from a shortened Minimum Average Maturity Period. This one-year requirement provides operational flexibility for industrial entities needing quick access to foreign capital for business purposes. For higher amounts or different sectors, the maturity period generally increases to three years or more to maintain stability.

12. (B) The amount involved in the delayed reporting or 100% of the amount involved

The Late Submission Fee serves as a penalty for delayed reporting of foreign investment transactions. The maximum cap for this fee is strictly limited to the total amount involved in the late filing. This ensures that the financial penalty does not exceed the value of the transaction itself, maintaining a proportionate approach to compliance enforcement while encouraging timely regulatory disclosures.

13. (C) 7 working days

Borrowers are required to report the actual transactions of their External Commercial Borrowings to the Reserve Bank of India on a monthly basis. This report, submitted via Form ECB 2 through an Authorized Dealer bank, must reach the regulator within seven working days from the end of the month. Regular reporting ensures transparency and allows the monitor of foreign debt.

14. (C) Rule 10 - Investments by FVCI

The Foreign Exchange Management (Non-Debt Instruments) Rules provide a specific framework for different investment types. While Rule 9 deals with share transfers and Rule 21 covers pricing, Rule 10 actually pertains to investments by Foreign Venture Capital Investors. Misidentifying these rules can lead to compliance errors, as each rule sets out the specific eligibility, pricing, and reporting requirements for investors.

15. (D) I, II, III and V only

The all-in-cost for foreign currency borrowings includes interest rates, fees, guarantees, and export credit agency charges. For new borrowings, the ceiling is set at five hundred basis points over the benchmark. Rupee-denominated borrowings have a ceiling of four hundred fifty basis points. However, withholding tax payable in Indian Rupees is specifically excluded from the all-in-cost calculation for regulatory purposes.

16. (D) FIRC in original obtained and endorsed and retained

While a Foreign Inward Remittance Certificate is necessary to prove the receipt of funds, the illustrative list for obtaining foreign investments typically focuses on documentation like memorandums, share purchase agreements, and entity master acknowledgments. The original certificate is often kept by the bank for processing, whereas other documents like the No Objection Certificate from joint holders are critical for compliance.

17. (B) Commitment fees

The all-in-cost framework for commercial borrowings covers interest, guarantee fees, and expenses paid in foreign currency. However, commitment fees and withholding taxes paid in Indian currency are excluded from this

limit. Understanding these exclusions is vital for borrowers when calculating the total cost of capital and ensuring they remain within the prescribed regulatory spreads over the benchmark rates.

18. (C) A letter confirming that a 5% interest element is included in the refund of the excess share application funds.

When refunding excess share application money to a foreign investor, the transaction must be reported to the regulator with a board resolution and original remittance certificates. However, there is no standard regulatory requirement to include a five percent interest element in such refunds. Refunds should typically represent the original principal amount received, provided the repatriation occurs within the allowed timeframes.

19. (A) The borrower must cover both principal and coupon through financial hedges from the time liability is created.

To mitigate exchange rate volatility, certain borrowers of foreign currency debt are required to maintain financial hedges. This requirement entails covering both the principal and the interest coupons from the moment the liability is recorded. Such hedging must be maintained throughout the tenure of the loan to ensure the borrower can meet repayment obligations regardless of currency fluctuations.

20. (D) Issuance of FCCBs shall conform to applicable regulations and must be issued without any warrants attached.

Foreign Currency Convertible Bonds are debt instruments issued in foreign currency that can be converted into ordinary shares. Their issuance must strictly follow the applicable government and Reserve Bank of India regulations. Furthermore, these bonds must be issued without any attached warrants. They offer a flexible funding option for companies while providing investors with potential upside through future equity conversion.

21. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Borrowers must immediately repatriate funds intended for domestic rupee expenditure to their

Indian bank accounts. Separately, unutilized funds may be temporarily invested in highly-rated liquid assets like short-term Treasury bills. While both statements are factually correct under debt management guidelines, the ability to invest unutilized funds does not serve as the underlying logical explanation for the immediate repatriation requirement.

22. (A) 1 year

For companies in the manufacturing sector, the regulatory framework allows for a shorter maturity period for smaller borrowings. Specifically, when raising up to fifty million dollars per financial year, the Minimum Average Maturity Period is reduced to one year. This provision supports the capital intensive nature of manufacturing by providing easier access to shorter-term foreign funding for essential industrial imports.

23. (C) Assertion (A) is true, but Reason (R) is false.

It is mandatory for borrowers to obtain a Loan Registration Number before drawing down any funds from an external commercial borrowing. However, the Authorized Dealer bank does not issue this number independently; instead, it must forward the application to the Reserve Bank of India for registration. The central bank remains the ultimate authority for issuing the registration number.

24. (A) It can be parked for up to 12 months cumulatively and must be kept in an unencumbered position.

Unutilized proceeds from external commercial borrowings intended for domestic use can be parked in term deposits with Indian banks. This is permitted for a maximum cumulative period of twelve months. During this time, the funds must remain unencumbered, meaning they cannot be used as collateral for other loans. This ensures the capital remains available for its intended productive purpose.

25. (C) Both I and II

Refinancing of foreign debt is permitted if the fresh borrowing does not reduce the outstanding maturity of the original loan. Additionally, the new borrowing must have an all-in-cost that is lower than the existing debt to ensure financial prudence. These conditions prevent the shortening of debt cycles and encourage entities

to seek more favorable terms in the international credit markets.

26. (B) USD 1 million or equivalent

Entities recognized as startups by the government are eligible to raise external commercial borrowings under the automatic route. The maximum limit for such borrowings is set at three million dollars or its equivalent per financial year. This specific limit is designed to provide startups with access to international capital while maintaining manageable debt levels during their early stages of growth.

27. (A) The total number of shares that would be outstanding if all possible sources of conversion are exercised.

In foreign investment regulations, “fully diluted basis” refers to the calculation of a company’s total equity share capital assuming all potential sources of conversion are exercised. This includes the conversion of debentures, warrants, and stock options. Using this basis ensures a transparent and accurate measurement of foreign ownership percentages, which is crucial for monitoring compliance with sectoral investment caps.

28. (C) 5 years

When a borrower raises a foreign currency denominated external commercial borrowing specifically for general corporate purposes or working capital, a longer maturity period is required. If the lender is a direct foreign equity holder, the Minimum Average Maturity Period is set at five years. This longer duration ensures that the debt remains stable and is used for sustainable business development purposes.

29. (B) Investment by a PROI in less than 10% of the paid-up equity capital of a listed company on a fully diluted basis.

Foreign Portfolio Investment is defined as the holding of equity instruments by a person resident outside India where the total holding is less than ten percent of the paid-up equity capital on a fully diluted basis. Such investments are typically made through stock exchanges. If the investment reaches or exceeds the ten percent threshold, it is reclassified as Foreign Direct Investment.

30. (B) Benchmark rate plus 500 bps spread

For new external commercial borrowings linked to an Alternative Reference Rate, the regulatory all-in-cost ceiling is established at five hundred basis points above the applicable benchmark. This spread accounts for the total cost of borrowing, including interest and various fees. Adhering to these ceilings prevents excessive borrowing costs and ensures that Indian companies access foreign capital at competitive market rates.

31. (D) The ceiling limit for PROI subscription to the paid-up capital of an Indian company as prescribed on a sector-wise basis.

A sectoral cap represents the maximum percentage of foreign investment allowed in a specific sector of the Indian economy. These limits are prescribed by the government and vary across different industries. They serve as a primary tool for regulating foreign capital inflows, ensuring that domestic interests are protected while allowing for international participation in key economic areas.

32. (B) Within 60 days of instrument transfer or receipt of funds, whichever occurs earlier.

When equity instruments are transferred between a non-resident and a resident, the transaction must be reported using the FC-TRS form. This filing must be completed within sixty days from the date of the transfer or the receipt of the funds, whichever occurs earlier. Timely reporting is essential for the regulator to monitor changes in foreign ownership and ensure compliance.

33. (D) I, II, III, IV and V

To be recognized as a startup, an entity must be a private company, partnership, or LLP incorporated within the last ten years. Its turnover must not exceed one hundred crore rupees in any financial year. Additionally, it must focus on innovation or improvement. Startups can also issue convertible notes that are repayable or convertible within a ten-year timeframe from issuance.

34. (B) On or before the 15th of July

The Annual Return on Foreign Liabilities and Assets is a mandatory filing for Indian companies that have received foreign direct investment or made overseas investments. This return must be submitted to the Reserve Bank of India on or before July fifteenth of every year. It provides

the regulator with critical data on the country's external financial position and investment stocks.

- 35. (A) Unregistered sole proprietorship firms**
Eligible entities for receiving foreign investment include Indian companies, Limited Liability Partnerships, and certain investment vehicles like SEBI-regulated Venture Capital Funds. However, unregistered sole proprietorship firms and ordinary trusts are generally prohibited from receiving foreign direct investment. This restriction ensures that foreign capital enters the economy through structured, legally recognized, and regulated business formats that allow for proper oversight.
- 36. (A) 100% of the amount involved in the delayed reporting**
The Late Submission Fee for delayed reporting of foreign investments is calculated based on the delay period and the transaction value. Regardless of how long the delay persists, the total penalty is capped at one hundred percent of the amount involved in the transaction. This ceiling prevents the penalty from becoming disproportionately high relative to the underlying investment amount being reported.
- 37. (B) Share warrants – 25% upfront**
Foreign investment regulations specify the minimum upfront payment required for certain capital instruments. For share warrants issued to non-residents, at least twenty-five percent of the total consideration must be received by the Indian company at the time of issuance. The balance must be paid within eighteen months. These rules ensure that foreign investors demonstrate a significant financial commitment from the outset.
- 38. (C) The all-in-cost of the fresh ECB must be lower than the all-in-cost of the existing ECB.**
In the context of refinancing existing external commercial borrowings, the primary regulatory requirement is that the fresh loan must result in better financial terms for the borrower. Specifically, the all-in-cost of the new borrowing must be lower than that of the original debt. This ensures that the refinancing exercise is economically viable and does not increase the debt burden.

- 39. (B) Purchase and long-term leasing of industrial land intended for new project modernization.**
While buying and selling land for profit or trading in development rights is prohibited under foreign investment rules, certain activities are exempted. The purchase and long-term leasing of industrial land for project modernization is not considered "Real Estate Business." Similarly, the development of townships and construction of residential or commercial premises are permitted activities under the housing and infrastructure sectors.

- 40. (A) Foreign Portfolio Investment (FPI)**
Under the current regulatory framework, any equity investment by a person resident outside India in a listed company that is less than ten percent of the paid-up capital on a fully diluted basis is classified as Foreign Portfolio Investment. These investments are generally made through the stock market and are subject to the rules and regulations governing portfolio investors.

- 41. (C) Assertion (A) is true, but Reason (R) is false.**
A non-resident holding equity in an Indian company is permitted to pledge those shares to an overseas bank to secure credit facilities. However, there is no requirement that the proceeds of such a loan must result in an immediate capital inflow into India. The loan can be used for the business purposes of the non-resident borrower outside the Indian territory.

- 42. (B) To supplement domestic capital for creation of capital assets within capital account management frameworks.**

The fundamental purpose of External Commercial Borrowings is to provide Indian entities with an additional source of funding to supplement domestic capital. These borrowings are intended for the creation of capital assets and the expansion of business operations. By accessing international markets, companies can often obtain longer-term funding at competitive rates, supporting overall economic growth within the capital account framework.

- 43. (A) Pricing Guidelines: Yes; Reporting: FCTRS**
Transfers of non-debt instruments from a non-resident to a resident through a sale must adhere to specific pricing guidelines to ensure the transaction occurs at fair value.

Furthermore, such transactions must be reported to the regulator using the FCTRS form. These requirements help maintain transparency in foreign exchange transactions and ensure that the valuation of Indian assets is consistent with market standards.

- 44.** (C) Cases are examined by AD Category I banks under the Automatic Route, while the Approval Route requires direct RBI authorization. The Automatic Route allows eligible borrowers to raise external commercial borrowings by approaching an Authorized Dealer Bank directly, provided the transaction fits within the prescribed limits and norms. In contrast, the Approval Route is reserved for cases that do not meet automatic criteria, requiring the borrower to submit a formal application to the Reserve Bank of India for specific examination.
- 45.** (B) I and III only
Entity Master creation is a process independent of the Authorized Dealer bank, allowing the entity to register itself on the FIRMS portal. A key procedural rule is that the individual named in the authorization letter as the entity user cannot sign the letter themselves. Additionally, the system is designed so that only one entity user can be registered per entity.
- 46.** (C) Registered micro-finance entities, such as Not-for-Profit Companies, are permitted to raise only INR denominated ECBs. While many entities can raise foreign currency debt, registered micro-finance institutions and certain not-for-profit companies are restricted to raising only Indian Rupee denominated external commercial borrowings. This policy protects these smaller, socially focused entities from the risks associated with foreign exchange fluctuations, ensuring their debt remains manageable in local currency terms while allowing them to access international funding sources.
- 47.** (D) I, II, IV and V only
A Business User can only be created once the Entity Master is established. The process requires providing the correct IFSC code for the bank and a specific board resolution. However, the authority letter used for the Business User is distinct from the one used for the Entity Master. Any issues or

resolutions during this process must be handled through the concerned Authorized Dealer bank.

- 48.** (D) I, II, III, IV and V
External commercial borrowing proceeds are subject to strict utilization rules and cannot be used for activities on the negative list. These prohibited uses include real estate activities, investments in the capital market, and equity investments. Furthermore, using debt proceeds for working capital or repayment of domestic rupee loans is generally prohibited, unless the funds are specifically raised from a direct foreign equity holder.
- 49.** (D) P-4, Q-2, R-3, S-1
Different forms track various types of foreign investment. Form DI is used for downstream investments by Indian companies. Form InVi handles reporting for investment vehicles issuing units to non-residents. Form CN is dedicated to the issuance and transfer of convertible notes by startups. Finally, the Depository Receipt Return tracks the issuance and transfer of depository receipts in the international market.
- 50.** (A) I and II only
To ensure the legitimacy of foreign debt, lenders must be residents of countries that comply with FATF or IOSCO standards. Multilateral and regional financial institutions where India is a member are also recognized. However, individuals are generally not permitted to act as lenders for external commercial borrowings unless they are direct foreign equity holders or meet other specific regulatory criteria.
- 51.** (C) Up to INR 1Cr – 0.05%
The Late Submission Fee for delayed reporting of foreign investments includes a variable component based on the transaction amount. For delayed filings involving an amount up to one crore rupees, the applicable rate for calculating this fee is zero point zero five percent per year. This sliding scale ensures that the penalty is proportionate to the size of the investment and the delay.

52. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Foreign branches of Indian banks are permitted to act as recognized lenders only for foreign currency denominated borrowings. Additionally, these branches are prohibited from underwriting any bond issuances by Indian entities in the international market. While both statements reflect banking and debt regulations, the prohibition on underwriting is a separate prudential measure and does not explain why they are restricted to foreign currency lending.

53. (C) P-3, Q-1, R-4, S-2

The Non-Debt Instruments Rules provide the legal framework for foreign investment. Rule 4 sets out restrictions on receiving investments, while Rule 3 outlines general restrictions on non-residents investing in India. Rule 8 governs the issuance of ESOPs and sweat equity shares to foreign employees. Rule 5 provides the general permission for non-residents to make investments in Indian equity instruments.

54. (A) P-2, Q-3, R-1, S-4

Maturity requirements vary based on the use of funds. Borrowings from a foreign equity holder for general corporate purposes require a five-year maturity. Manufacturing companies raising smaller amounts have a one-year requirement. Startups must maintain a three-year average maturity. If funds are used to repay domestic rupee loans for capital expenditure, the required minimum average maturity increases to seven years.

55. (B) I, II, III and IV

To process foreign investment inflows, companies must provide a comprehensive set of documents. This includes the inward application with a FEMA declaration, a brief company profile with the correct NIC code, and the Memorandum of Association. Additionally, a six-point KYC report via SWIFT from the remitting bank is required to verify the source of funds and the identity of the investor.

56. (C) Assertion (A) is true, but Reason (R) is false. For fixed rate loans, the combined swap cost and spread must not exceed the applicable floating rate plus the spread. However, the definition of

all-in-cost for external commercial borrowings specifically excludes commitment fees and withholding taxes paid in Indian Rupees. These exclusions are important for borrowers to consider when ensuring their total borrowing costs remain within regulatory limits.

57. (A) I, II, III and IV

Refunding foreign investment proceeds requires specific documentation to ensure the repatriation is legitimate. This includes the outward application form, copies of the original reporting reference numbers, and a formal letter explaining the reason for the refund. A board resolution confirming that the funds were received as share application money and are now being returned is also a mandatory requirement.

58. (B) I, II and IV only

Borrowers have the flexibility to change the currency of their debt from a foreign currency to Indian Rupees. Most eligible borrowers can raise up to seven hundred fifty million dollars annually under the automatic route. Furthermore, mandated financial hedging must start from the time the liability is created. However, Indian banks are generally prohibited from providing guarantees for external commercial borrowings.

59. (C) Both I and II

Under foreign exchange regulations, "Real Estate Business" is narrowly defined to exclude several key activities. Brokerage services for the sale or purchase of property are not considered real estate business. Similarly, the construction of residential or commercial premises and the development of townships are excluded from the definition, meaning they are generally open to foreign direct investment under specific conditions.

60. (C) Changes must be reported through revised Form ECB not later than 7 days from the changes effected.

When changes are made to the parameters of an existing external commercial borrowing, such as the interest rate or maturity, they must be reported to the Reserve Bank of India. The reporting requirement is through a revised Form ECB and must be completed within seven days from the date the changes were effected. Regular

and timely reporting ensures transparency and allows the monitor of foreign debt.

- 61.** (B) A holder with a minimum indirect equity holding of 51%.

An indirect equity holder is recognized as an eligible lender if they hold a minimum of fifty-one percent indirect equity in the Indian borrowing entity. This typically occurs through a common overseas parent or intermediate holding company. This definition ensures that the lender has a significant, albeit indirect, controlling interest in the borrower, justifying the provision of debt capital.

- 62.** (D) Yes, provided India is a member country of that Multilateral or Regional Financial Institution.

Multilateral and regional financial institutions are permitted as recognized lenders for external commercial borrowings. The primary condition for their eligibility is that India must be a member country of the specific institution. This allows Indian companies to access funding from major international development and financial organizations, which often provide favorable terms for infrastructure and industrial projects.

- 63.** (B) Yes, because in the case of a recognized startup, the period is valid up to 10 years.

According to the Department for Promotion of Industry and Internal Trade, an entity remains recognized as a startup for up to ten years from its date of incorporation. Since BioNext was incorporated eight years ago and meets the turnover criteria, it continues to be eligible for startup benefits, including the special provisions for receiving foreign investment and raising debt under the startup framework.

- 64.** (D) I and II only

The Late Submission Fee for delayed ECB reporting applies to delays ranging from a few days to over three years. The fee amount varies between five thousand and one hundred thousand rupees per year, depending on the length of the delay. This penalty system applies to all borrowers, regardless of whether they operate under the automatic or approval route.

- 65.** (B) 3 years

The regulatory framework for external commercial borrowings raised by recognized startups prescribes a specific maturity period. These entities must maintain a Minimum Average Maturity Period of three years. This requirement ensures that the foreign debt raised by startups is relatively stable, providing them with a medium-term capital base to support their innovation and development activities without immediate repayment pressure.

- 66.** (A) Only I

Converting external commercial borrowings into equity is permitted provided the company's business activity falls under the automatic route for foreign direct investment. However, such a conversion cannot be done without the explicit consent of the lender. Furthermore, the conversion must comply with the pricing guidelines applicable to equity instruments to ensure that the shares are issued at a fair market value.

- 67.** (D) 7:1

When an Indian company raises an external commercial borrowing in foreign currency from a direct foreign equity holder, it must adhere to specific leverage limits. For borrowings exceeding five million dollars, the maximum permissible ratio of outstanding ECB liability to the equity capital is seven to one. This limit ensures that the company maintains an adequate equity cushion against its foreign debt obligations.

- 68.** (D) The investment continues as FDI, following the regulatory principle of "Once an FDI, always an FDI."

The regulatory principle of "Once an FDI, always an FDI" applies to foreign investments in Indian listed companies. If an initial investment of ten percent or more is made, it is classified as Foreign Direct Investment. Even if the holding subsequently falls below ten percent due to share dilution or sales, it continues to be treated and reported as FDI.

- 69.** (C) Investments by an Indian entity, which is not owned or controlled by resident Indians, into the equity of another Indian company.

Downstream investment refers to indirect foreign investment where an Indian company that has

received foreign investment, and is either foreign-owned or foreign-controlled, invests in the equity of another Indian company. Such investments must comply with the same sectoral caps and entry routes as direct foreign investments to ensure that foreign capital is monitored across all ownership levels.

70. (A) P-2, Q-3, R-1, S-4

Various investment vehicles are governed by specific SEBI regulations. Alternative Investment Funds are regulated under the 2012 rules. Foreign Portfolio Investors fall under the 2019 regulations. Infrastructure Investment Trusts and Real Estate Investment Trusts are governed by their respective 2014 regulations. These rules provide the operational and compliance framework for these entities to function in the Indian capital markets.

71. (B) FCTRS

The Foreign Capital Transfer Report (FCTRS) is the mandatory form used for reporting the transfer of equity instruments between a person resident outside India and a person resident in India. This form must be filed on the FIRMS portal within sixty days of the transfer or receipt of funds. It captures the details of the buyer, seller, price, and the instruments being transferred.

72. (B) Erstwhile OCBs - Who are under the RBI caution list

Overseas Corporate Bodies (OCBs) were derecognized as a class of investors several years ago. While some may still hold investments, they are not currently eligible to make new investments. The statement incorrectly links their status solely to a caution list, whereas their primary restriction stems from their general derecognition. Other entities like NRIs and FPIs remain eligible under specific conditions.

73. (B) The Resident Transferee

In a transaction involving the sale of equity instruments from a non-resident to a resident of India, the primary responsibility for reporting the transfer lies with the resident party. The resident transferee must ensure that the FCTRS form is filed accurately and within the prescribed sixty-day timeframe on the FIRMS portal to remain in compliance with foreign exchange regulations.

74. (C) I, II, III, IV and V

Foreign investors can subscribe to various equity-linked instruments. These include fully and partly paid equity shares, where partly paid shares require a twenty-five percent upfront payment. Other eligible instruments include fully and mandatorily convertible debentures and share warrants. Startups are also permitted to issue convertible notes that must be repaid or converted into equity within a ten-year period from issuance.

75. (A) 0.05%

The Late Submission Fee for reporting delays includes a variable component based on the amount involved in the transaction. For amounts up to one crore rupees, a rate of zero point zero five percent per year is applied to calculate the penalty. Since the amount in question is eighty lakh rupees, this lower percentage is used to determine the financial liability for the delay.

76. (C) I, II and III only

Certain sectors are completely closed to foreign investment for social, ethical, or economic reasons. These prohibited areas include the lottery business, chit funds, and Nidhi companies. Additionally, the manufacture of tobacco and its substitutes is restricted. However, the development of industrial parks and integrated townships is a permitted activity and is not included in the list of prohibited sectors.

77. (B) The outstanding maturity of the original borrowing must not be reduced.

When an Indian company decides to refinance an existing external commercial borrowing with a fresh one, it must ensure that the debt profile does not worsen. A key regulatory condition is that the outstanding maturity of the original loan must not be reduced by the new borrowing. This prevents the acceleration of repayment obligations and helps maintain a stable external debt maturity profile.

78. (D) I, II and III

A non-resident is permitted to pledge shares of an Indian company to a bank in India to secure credit facilities for that company. This is allowed for genuine business purposes. To ensure compliance, the company's statutory auditor must provide a declaration or certificate

confirming that the loan proceeds will be used specifically for the stated business purposes.

- 79.** (D) Permitted only if the borrower is a highly rated corporate or a Maharatna/Navratna Public Sector Undertaking.

Participation of foreign branches or subsidiaries of Indian banks in the refinancing of external commercial borrowings is restricted. This activity is only permitted if the borrower is a highly rated Indian corporate or a prominent Public Sector Undertaking, such as a Maharatna or Navratna company. These restrictions are in place to manage the systemic risk and exposure of the banking system.

- 80.** (C) Assertion (A) is true, but Reason (R) is false. Non-residents are permitted to pledge their equity holdings in Indian companies to overseas banks as security for credit facilities. However, there is no regulatory requirement that the loan proceeds must result in a capital inflow to India. The funds can be utilized by the non-resident borrower for their global operations, provided the pledge is created in accordance with FEMA guidelines.

NODIA

CHAPTER 07

Risks in Foreign Trade - Role of ECGC

May/June 2016

1. Read the following scenario and answer the question that follows:

An Indian exporter ships merchandise to an independent overseas agent under an agency agreement. The goods are held in stock by the agent for future sales.

While the goods are sitting in the agent's warehouse waiting for ultimate buyers, an unexpected localized event destroys the stock. Under the Consignment Exports (Stock-holding Agent) policy, at whose risk were these goods while being held by the agent?

- (A) At the risk of the local warehouse authority.
- (B) At the risk and on behalf of the principal exporter.
- (C) At the absolute risk of the stock-holding agent.
- (D) At the joint risk of the ultimate buyers and the agent.

Oct/Nov 2009

2. Which of the following pairs relating to the Exchange Fluctuation Risk Cover Scheme is INCORRECTLY matched?

- (A) Minimum scheduled payment period – Beyond 12 months
- (B) Maximum scheduled payment period – Up to 15 years
- (C) Maximum loss portion made good by the insurer – Exceeding 2% but not exceeding 50% of the reference rate
- (D) Reference rate deductible – 2%

May/June 2023

3. Which of the following best defines 'Legal Risk' in international trade?

- (A) Risks arising from amendments in national laws, such as trade embargoes or export bans.
- (B) Risks involving goods being abandoned or siphoned off by local transporters at the port.
- (C) Risks involving financial uncertainty

resulting in the externalization of exchange issues.

- (D) Risks of an overseas buyer defaulting due to sudden insolvency or a severe financial crunch.

Oct/Nov 2018

4. Consider the following statements regarding the IT-Enabled Services (Single Customer) Policy (SITES):

- I. One policy for one buyer is issued for a period of 12 months, covering up to 80% extent of cover.
- II. Premium is payable strictly on the actual amount of shipments effected to the buyer, regardless of the approved Loss Limit.

Which of the statements given above is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

May/June 2007

5. How is the 'Customer Specific Policy Cover' defined within export credit insurance offerings?

- (A) A policy issued exclusively to small-scale exporters with an annual turnover below Rs. 10 lakhs.
- (B) A base cover assigned to exporters dealing with Restricted Cover - Group II category countries.
- (C) A policy formulated for banks providing foreign currency loans for overseas infrastructure works.
- (D) A tailored policy for large value exporters combining various features of standard policy types.

Oct/Nov 2025

6. Consider the following statements regarding the Whole Turnover Post-shipment (WT-PS) insurance cover:

- I. The extent of cover for non-Policyholders

varies from 50% to 75% depending upon the claim premium ratio of the bank.

- II. For bills drawn on Associates of non-Policyholders, the coverage provided is 60%. Which of the statements given above is/are correct?
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

May/June 2012

7. According to regulatory guidelines on country risk, banks are required to make provisions if their exposure to any one country on the balance sheet date equals or exceeds what percentage of their total assets?
- (A) 0.5%
(B) 1.0%
(C) 2.0%
(D) 5.0%

Oct/Nov 2014

8. Consider the following statements regarding the Buyer Exposure Policy:
- I. It provides cover against commercial and political risks attached to a specific buyer for both non-LC and LC transactions.
II. The policy is issued for each buyer covering all exports to be made to the buyer during a period of twelve months.
III. If an exporter opts for commercial and political risks cover, failure of any LC opening bank worldwide is automatically covered without any World Ranking restriction.
- Which of the above statement(s) is/are correct?
- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

May/June 2019

9. What is the designated extent of cover provided under the credit insurance policy for the SME Sector (Micro Exporters Policy)?
- (A) 75%
(B) 80%
(C) 90%
(D) 95%

Oct/Nov 2006

10. Consider the following statements regarding the Customer Specific Policy Cover:
- I. It is issued to large exporters on a selective basis to address specific needs not fully met by standard products.
II. These policies can be issued combining features of more than one standard type (off the shelf) policy.
III. They are considered only in cases where the anticipated annual premium is more than Rs. 10 lakhs.
- Which of the above statement(s) is/are correct?
- (A) I and II only
(B) I and III only
(C) II and III only
(D) I, II, and III

May/June 2021

11. Conceptually, why does export credit insurance generally lead to a lower cost of borrowing or financing for exporters?
- (A) The government agency bears the risk of default, providing protection that enhances the creditworthiness of the transaction.
(B) It eliminates the necessity for commercial banks to maintain any reserve requirements with the central bank.
(C) It legally prohibits the financing bank from charging an interest rate higher than the domestic prime lending rate.
(D) It allows the exporter to draw funds directly from the central bank without involving commercial financial institutions.

Oct/Nov 2010

12. Consider the following commercial risks covered by Short-Term Standard Policies:
- I. Insolvency of the buyer.
II. Commercial disputes relating to quality raised by the buyer without a decree from a competent court.
III. Failure of the buyer to make the payment due within a specified period (normally 4 months).
IV. Buyers' failure to accept the goods, subject to certain conditions.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
(B) I, III, and IV
(C) II, III, and IV
(D) I, II, III, and IV

NODIA

May/June 2005

13. How is 'open cover' conceptually differentiated from 'restricted cover' countries in export insurance?
- Open cover requires advance premium payments, whereas restricted cover allows for payments in arrears.
 - Open cover has no political risk limits, whereas restricted cover requires case-by-case approvals.
 - Open cover is limited to US Dollar transactions, whereas restricted cover accepts any convertible currency.
 - Open cover applies to short-term policies, whereas restricted cover applies to long-term investments.

Oct/Nov 2022

14. Consider the following statements about the Exchange Fluctuation Risk Cover Scheme:
- Cover is available for payments scheduled over a period beyond 12 months up to a maximum of 15 years.
 - The contract cover provides a deductible of 2%.
 - The insurer will make good the portion of loss in excess of 2%, up to a maximum of 35% of the reference rate.
 - Gains or losses beyond 35% of the reference rate accrue entirely to the exporter's account.
- Which of the above statement(s) is/are correct?
- I, II, and III
 - I, III, and IV
 - II, III, and IV
 - I, II, and IV

May/June 2018

15. Which of the following is a correct statement about Export Credit Insurance for Banks (Whole turnover - Packing Credit)?
- The premium on the WTPC insurance is entirely borne by the financing bank.
 - Banks are not required to notify the limits sanctioned to their exporter customer if they hold this policy.
 - It solely covers advances granted against export incentives receivables at the post-shipment stage.
 - A higher percentage of cover is available at a lower premium since a large volume of business is offered.

Oct/Nov 2016

16. Consider the following statements regarding the responsibilities of an exporter under standard credit insurance policies:
- Shipments are adequately covered by a valid Credit Limit (CL) and Loss Limits (LL).
 - Specific approval is obtained if export proceeds are to be received from Restricted Cover Countries.
 - Shipment declarations are submitted on or before the 15th of every month.
 - Claims are filed within 360 days from the date of shipment regardless of the due date.
- Which of the above statement(s) is/are correct?
- I, II, and III
 - I, II, and IV
 - I, III, and IV
 - II, III, and IV

May/June 2014

17. Which of the following is a correct statement regarding the Export Turnover Policy?
- It is explicitly restricted to small exporters with a turnover of less than Rs. 50 lakhs.
 - It provides for higher discretionary credit limits on overseas buyers, based on the total premium paid.
 - It involves a fixed premium with no provision for adjustments or discounts at the end of the year.
 - The policy is issued with a permanent validity period requiring no annual renewal.

Oct/Nov 2007

18. Consider the following statements regarding the Transfer Guarantee:
- It applies when a bank adds its confirmation to a foreign letter of credit.
 - The confirming bank binds itself to honour the drafts drawn by the beneficiary without recourse.
 - The drafts must be strictly in accordance with the terms of the letter of credit.
 - It safeguards banks against possible loss arising out of the foreign bank's failure to reimburse.
 - The guarantee exclusively covers the commercial default of the individual overseas buyer, ignoring the foreign bank's status.
- Which of the above statement(s) is/are correct?
- I, II, III, and IV

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- (B) I, II, III, and V
- (C) I, III, IV, and V
- (D) II, III, IV, and V

May/June 2025

19. Identify the INCORRECT statement regarding the Export Production Finance Guarantee.
- (A) The extent of cover and premium are identical to those applied under post-shipment export credit insurance.
 - (B) It covers advances given by banks against incentives/receivables at the pre-shipment stage.
 - (C) Banks having Whole Turnover Packing Credit (WT-PC) insurance are eligible for a concessional premium rate under this guarantee.
 - (D) It is designed to protect bankers against losses on account of their financial lending to exporter clientele.

Oct/Nov 2019

20. Identify which of the following are classified as Political Risks covered under Standard Policies:
- I. War, revolution, or civil disturbances in the buyer's country.
 - II. New import licensing restrictions in the buyer's country.
 - III. Interruption or diversion of voyage outside India resulting in unrecoverable additional freight.
 - IV. Protracted default by the overseas buyer to pay for accepted goods.
 - V. Any other cause of loss occurring outside India not normally insured by general insurers and beyond the control of both exporter and buyer.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V
 - (B) I, II, III, and IV
 - (C) II, III, IV, and V
 - (D) I, III, IV, and V

May/June 2009

21. Identify the INCORRECT statement regarding the handling and settlement of claims by a credit guarantee corporation.
- (A) Claims are directly paid to the commercial bank that originally handled the export documentation.
 - (B) Exporters must submit formal claim forms within 12 months from the due date of the

unpaid bills.

- (C) Claims will not be settled by the insurer for more than four buyers during any one policy period.
- (D) Settlement of the claim amount relieves the exporter of the responsibility of realizing proceeds.

Oct/Nov 2011

22. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer:

Assertion (A): Export credit insurance lowers the cost of borrowing and financing for exporters.

Reason (R): The government agency bears the risk of default on a risk-sharing basis, reducing the risk premium charged by financing banks.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2010

23. Standard credit insurance policies provide cover against various risks. However, they do NOT cover losses arising from which of the following?
- (A) New import licensing restrictions in the buyers' country
 - (B) Failure of the exporter to fulfil the terms of the export contract
 - (C) Interruption of voyage resulting in additional freight charges
 - (D) Insolvency of the overseas buyer

Oct/Nov 2024

24. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer:

Assertion (A): Banks are required to pay an upfront one-month premium on financial guarantees based on previous years' average.

Reason (R): These insurance products fall under the purview of regulatory authorities and must comply with general insurance guidelines.

NODIA

fluctuations.

- (B) Seller risk involves failing to secure finance, while buyer risk involves failing to secure LCs.
- (C) Seller risk involves buyer-side delays or poor quality, while buyer risk involves non-payment.
- (D) Seller risk involves political embargoes, whereas buyer risk involves local port authority strikes.

May/June 2019

51. Under the Consignment Exports (Stock-holding Agent) policy, consider the following statements:

- I. The merchandise must be shipped to an overseas entity in pursuance of an agency agreement.
- II. The overseas agent must be an independent and separate legal entity with no associate/sister concern relationship with the exporter.
- III. The sales made by the agent would be at the agent's absolute risk, releasing the principal exporter from any liability.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2006

52. What does the concept of 'risk sharing basis' imply in the context of export credit guarantees and policies?

- (A) The premium is shared equally with the overseas buyer's insurance agency.
- (B) The risk is distributed equally among all commercial banks participating in the export consortium.
- (C) The insurer guarantees 100% of the principal amount while the financing bank assumes 100% of the interest rate risk.
- (D) The cover provided is not for 100% of the value, requiring the exporter or bank to bear a part of the loss.

May/June 2021

53. Consider the following statements regarding the Export Turnover Policy:

- I. It is for the benefit of large exporters who contribute not less than Rs. 10 lakhs per annum towards premium.
- II. It provides for an additional discount in

premium with an added incentive for increasing exports beyond the projected turnover.

- III. It provides for lower discretionary credit limits on overseas buyers to mitigate high-value risks.
- IV. The policy is issued with a validity period of one year.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

Oct/Nov 2010

54. Which of the following is a correct statement regarding Country Risk in international trade?

- (A) Country risk is caused exclusively by the insolvency of a private overseas buyer or retail importer.
- (B) The IMF Quota of a country is completely irrelevant when assessing its internal country risk profile.
- (C) Banks can adopt the country risk classifications published by authorized credit guarantee corporations.
- (D) Credit agencies classify all countries into three broad categories: Insignificant, Moderate, and High.

May/June 2005

55. Consider the following statements regarding Overseas Investment Insurance:

- I. Any investment made by way of equity capital or untied loan for setting up or expanding overseas projects is eligible.
- II. The investment may be in cash or in the form of export of Indian capital goods and services.
- III. Commercial risks of the joint venture are fully covered under the scheme.
- IV. For an investment to qualify, there should preferably be a bilateral agreement protecting investment between the two countries.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) I, III, and IV
- (D) II, III, and IV

R. Contracts (Comprehensive Risks) Policy

S. Contracts (Political Risks) Policy

List II: (Risk Coverage)

1. Covers only political risks from the date of contract.
2. Covers both commercial and political risks from the date of contract.
3. Covers only political risks from the date of shipment.
4. Covers both commercial and political risks from the date of shipment.

(A) P-1, Q-4, R-2, S-3

(B) P-4, Q-3, R-2, S-1

(C) P-3, Q-1, R-4, S-2

(D) P-2, Q-3, R-1, S-4

Oct/Nov 2008

32. Match the specific insurance schemes or features in List I with their corresponding maximum limit or coverage parameters in List II:

List I: (Scheme or Feature)

P. Policy for SME Sector (Extent of cover)

Q. Standard Policies (Extent of cover)

R. Factoring Service (Finance against approved transactions)

S. Buyer Exposure Policy (Bank World Ranking limit for LC coverage)

List II: (Coverage Parameter)

1. 90% of the value of exports
2. Up to 90%
3. 90%
4. Up to 25,000

(A) P-2, Q-3, R-1, S-4

(B) P-3, Q-1, R-2, S-4

(C) P-1, Q-4, R-2, S-3

(D) P-4, Q-2, R-3, S-1

May/June 2006

33. Which of the following pairs correctly matches the country risk classification with its corresponding category grade?

(A) Insignificant Risk – A2

(B) High Risk – C2

(C) Moderately low risk – B2

(D) Low Risk – B1

Oct/Nov 2017

34. Read the following scenario and answer the question that follows:

Exporter A's shipments are severely delayed because the raw material supplier's factory experienced an unexpected labour strike, resulting

in late delivery of goods to the port. According to the categorization of risks in international trade, under which specific risk classification does this event fall?

(A) Shipping Risk

(B) Legal Risk

(C) Operational Risk

(D) Credit Risk

May/June 2008

35. Read the following scenario and answer the question that follows:

A commercial bank extends post-shipment advances to an exporter who is an existing Policyholder of the insurer. The exporter suffers a protracted default. Depending on the claim premium ratio of the bank, what is the maximum and minimum extent of cover the bank can expect from the insurer under the Whole-turnover Post-shipment (WT-PS) insurance?

(A) 50% to 75%

(B) 60% fixed

(C) 90% to 95%

(D) 100% full indemnity

Oct/Nov 2013

36. Read the following scenario and answer the question that follows:

A bank issues a financial guarantee and the exporter client defaults. The due date of recall is January 1st. To strictly comply with regulatory guidelines, by what date must the bank file the notice of default, and subsequently, by what date must the actual claim be filed?

(A) Filing notice by Feb 1st; Filing claim by Aug 1st.

(B) Filing notice by Mar 1st; Filing claim by May 1st.

(C) Filing notice by Apr 1st; Filing claim by Dec 1st.

(D) Filing notice by May 1st; Filing claim by Nov 1st.

May/June 2015

37. Read the following scenario and answer the question that follows:

An overseas buyer faces financial difficulties and requests the Indian exporter to grant a 20% discount on the existing invoice value for immediate settlement. The exporter's shipments are fully covered under a Standard Policy. What mandatory action must the exporter take before

Oct/Nov 2019

62. All of the following are factors that need to be assessed while reviewing country risk, EXCEPT:
- (A) Exchange Rate Volatility
 - (B) Gross Domestic Product (GDP)
 - (C) The physical distance between the importing and exporting seaports
 - (D) Balance of Payment

May/June 2009

63. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer:

Assertion (A): Standard credit insurance policies do not cover losses arising from the buyer's failure to obtain necessary import or exchange authorization from authorities in their country.

Reason (R): These policies solely cover legal risks originating from the exporter's home country.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2011

64. All of the following are characteristics or eligibility criteria for the Policy for SME Sector (Micro Exporters Policy), EXCEPT:
- (A) The policy particularly provides the SME Sector easy administrative and operational convenience.
 - (B) It offers an extent of cover of 90%.
 - (C) It can be issued to an exporter qualifying as per small and medium enterprise definitions.
 - (D) The policy is exclusively issued with a mandatory validity period of 36 months.

May/June 2010

65. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer:

Assertion (A): Insurers place no limit on

covering political risks for countries designated as 'restricted cover' countries.

Reason (R): For a majority of countries, specific approvals are given on the merits of each case with a validity period of six months.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

66. Exporters hold specific responsibilities to ensure their policies remain valid and effective. Which of the following is NOT a standard responsibility for exporters under credit insurance policies?

- (A) Ensure the maximum liability under the policy is sufficient to cover amounts due at any given point.
- (B) Ensure specific approval is obtained if export proceeds are from any Restricted Cover Countries.
- (C) Ensure independent settlements are negotiated with defaulting buyers without insurer interference.
- (D) Ensure claims are filed with the insurer within 360 days from the original due date of payment.

May/June 2017

67. Read the following scenario and answer the question that follows:

An Indian exporter invoices a shipment in US Dollars. After the goods are exported, the Indian Rupee unexpectedly strengthens significantly against the US Dollar before the payment is received. What specific type of risk has the exporter encountered that resulted in a financial loss?

- (A) Exchange Risk
- (B) Country Risk
- (C) Spread Risk
- (D) Operational Risk

Oct/Nov 2005

68. What is the most appropriate description of the scope of Specific Shipment Policies?

- (A) Policies designed to cover the entire annual export turnover of an exporter irrespective of credit terms.

- I. A Small Exporter is defined as an exporter whose anticipated total export turnover for the period of 12 months ahead is not more than Rs. 50 lakhs.
- II. The policy is issued to cover shipments that may be made in a period of 24 months ahead.

Which of the statements given above is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2009

44. What is the defining characteristic of the 'Maturity Factoring' service?
 - (A) Financing of export bills excluding credit protection or sales ledger maintenance services.
 - (B) Provision of counter guarantees to financing banks against possible losses on bid-bonds.
 - (C) Provision of financing and receivable collection with a full buyer default credit guarantee.
 - (D) Provision of fixed 50% advances against unapproved transactions for one-off counter trades.

May/June 2023

45. Consider the following statements regarding eligibility for Maturity Factoring:
 - I. It requires the exporter to deal on DA terms or open account terms with buyers on a continuous relationship basis.
 - II. It is highly suitable for exports involving counter trade mechanisms.

Which of the statements given above is/are correct?

 - (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2018

46. In which year was the Export Risks Insurance Corporation (ERIC) established in India?
 - (A) 1957
 - (B) 1964
 - (C) 1999
 - (D) 2008

May/June 2007

47. Consider the following objectives of an export credit agency:
 - I. To facilitate availability of adequate bank finance to Indian exporters at competitive rates.
 - II. To assist Indian exporters in managing credit risks by providing timely information on the worthiness of buyers, bankers, and countries.
 - III. To assume 100% of the financial risk on behalf of exporters to guarantee absolute export growth.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2025

48. Under the Overseas Investment Insurance, the period of insurance cover can be extended up to a maximum of how many years from the date of commencement of investment?
 - (A) 10 years
 - (B) 12 years
 - (C) 15 years
 - (D) 20 years

May/June 2012

49. Consider the following statements regarding Insurance Cover for Buyer's Credit and Line of Credit:
 - I. Buyer's Credit enables an overseas buyer to pay for machinery and equipment imported from India for a specific project.
 - II. The loss coverage provided under this scheme for commercial risks is 90%.
 - III. A Line of Credit is extended exclusively to individual retail importers in an overseas country for consumer goods.

Which of the above statement(s) is/are correct?

 - (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2014

50. In international trade, how is 'Seller Risk' conceptually differentiated from 'Buyer Risk'?
 - (A) Seller risk relates to shipping disruptions, whereas buyer risk relates to exchange

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2017

25. Overseas Investment Insurance covers several risks. Which of the following risks is NOT covered under this scheme?
- (A) Commercial risks of the joint venture failing
 - (B) Expropriation of the investment
 - (C) Restriction on remittances
 - (D) War and civil disturbances

Oct/Nov 2005

26. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer:

Assertion (A): Commercial disputes regarding quality raised by the buyer are generally not covered under Short-Term policies.

Reason (R): Exporters can only claim for commercial quality disputes if they obtain a decree from a competent court of law in the buyer's country in their favour.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

27. Which of the following is the most appropriate combination of tools to mitigate direct exchange risk in international trade?
- (A) Forward covers, futures, and foreign currency accounts
 - (B) Bank guarantees and letters of comfort
 - (C) Export Production Finance and Transfer Guarantees
 - (D) Standard insurance policies and Discretionary Limits

Oct/Nov 2015

28. What is the most appropriate action a bank can take upon receiving a claim amount directly from the insurer for handled export documents?
- (A) The bank must place the funds in an escrow account until the overseas buyer officially declares bankruptcy.
 - (B) The bank can appropriate the claim amount directly to the post-shipment advance account, if any.
 - (C) The bank must refund the exact amount to the exporter's operational account immediately without deduction.
 - (D) The bank is required to transfer the amount to the central bank's foreign exchange reserve pool.

May/June 2013

29. What is the most appropriate reason for an exporter to maintain a sufficient advance premium deposit with the insurer?
- (A) To qualify for the maximum allowable discretionary limit on foreign bank LCs.
 - (B) To qualify for simplified administrative reporting during low-turnover fiscal periods.
 - (C) To legally bypass the requirement of submitting monthly shipment declarations.
 - (D) To ensure the policy covers the premium that will become payable for future shipments to be effected.

Oct/Nov 2021

30. For financial guarantees issued to banks, arrange the following steps in the correct chronological order of required compliance:
- I. Lodging of the formal claim
 - II. Occurrence of the due date or date of recall
 - III. Receipt of the refund based on the risk-sharing ratio after collateral realization
 - IV. Submission of the notice of default
- (A) I, II, IV, III
 - (B) II, I, IV, III
 - (C) II, IV, I, III
 - (D) IV, II, I, III

May/June 2024

31. Match the specific types of Standard Policies in List I with their exact risk coverage scopes in List II:
- List I: (Type of Policy)
- P. Shipment (Comprehensive Risk) Policy
 - Q. Shipment (Political Risks) Policy

Oct/Nov 2022

56. Identify the correct statement concerning the submission of monthly declarations by banks having whole turnover insurance.
- (A) The declaration must show total amounts financed during the month and products thereof along with the premium.
 - (B) Banks are required to submit declarations only at the end of the financial year.
 - (C) Monthly declarations are only mandatory for non-policyholder exporters availing single-transaction finance.
 - (D) The submission of monthly declarations officially waives the requirement for obtaining discretionary limits.

May/June 2018

57. Consider the following risks and identify those NOT covered by Standard Policies:
- I. Causes inherent in the nature of goods.
 - II. Exchange rate fluctuation risk.
 - III. Imposition of restrictions by the Government of the buyer's country blocking payment.
 - IV. Default or insolvency of the collecting bank.
 - V. Failure of the exporter to fulfil the terms of the export contract.
- Which of the above statement(s) is/are correct?
- (A) I, II, IV, and V
 - (B) I, II, III, and IV
 - (C) II, III, IV, and V
 - (D) I, III, IV, and V

Oct/Nov 2016

58. Which of the following is an INCORRECT statement regarding Operational Risk in international trade?
- (A) It relates to operational issues at both the buyer's and seller's ends, or even at supporting organizations.
 - (B) It encompasses the risk of an overseas buyer going bankrupt due to massive currency devaluation.
 - (C) Strikes at the seller's factory or at the raw material suppliers' factory fall under this category.
 - (D) Errors by operating staff and communication disruptions can lead to delays classified as operational risk.

May/June 2014

59. Consider the following facilities provided by a factoring service:

- I. Facilitates purchase of account receivables.
 - II. Provides up to 90% finance against approved transactions.
 - III. Maintenance of sales ledger.
 - IV. Full credit guarantee on the buyer's default or insolvency.
 - V. Follow-up for collection of export proceeds.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV
 - (B) II, III, IV, and V
 - (C) I, III, IV, and V
 - (D) I, II, III, IV, and V

Oct/Nov 2007

60. Which of the following statements about Discretionary Limits (DL) prescribed by credit guarantee corporations is INCORRECT?
- (A) DL is a limit up to which banks are permitted to allow finance without prior approval of the insurer.
 - (B) When banks operate within the DL, they are only required to send a notification or report in a prescribed format.
 - (C) Discretionary Limits apply solely to specific shipment policies and are invalid for financial guarantees issued to banks.
 - (D) Exceeding the sanctioned Discretionary Limit requires prior approval of the insurer before the release of further limits.

May/June 2025

61. Consider the following statements regarding the Buyer Exposure Policy:
- I. It provides cover against commercial and political risks attached to a specific buyer for both non-LC and LC transactions.
 - II. The policy is issued for each buyer covering all exports made over a 24-month period.
 - III. Failure of the LC opening bank is covered for banks with a World Ranking up to 25,000.
 - IV. Specific approval is required for covering any bank with a ranking beyond 25,000.
 - V. Exporters holding a Standard Policy can exclude shipments covered under a Buyer Exposure Policy from the Standard Policy's purview.
- Which of the above statement(s) is/are correct?
- (A) I, III, IV, and V
 - (B) I, II, III, and IV
 - (C) II, III, IV, and V
 - (D) I, II, IV, and V

accepting this offer to ensure the policy cover remains intact?

- (A) The exporter must demand a letter of credit from the buyer's bank.
- (B) The exporter must obtain a decree from a competent court in the buyer's country.
- (C) The exporter must secure prior approval from the insurer.
- (D) The exporter must immediately file a notice of default.

Oct/Nov 2012

38. Read the following scenario and answer the question that follows:

During a single policy period, an exporter experiences protracted defaults from six different overseas buyers due to an unexpected regional economic crisis. The exporter files legitimate claims for all six buyers. Based on standard operational rules for claims, how will the insurer handle the settlement?

- (A) The insurer will settle claims for all six buyers proportionately.
- (B) The insurer will reject all claims as regional economic crises constitute uninsurable aggregate limits.
- (C) The insurer will only settle claims for buyers located in open cover countries.
- (D) The insurer will settle claims for a maximum of four buyers during the policy period.

May/June 2011

39. Read the following scenario and answer the question that follows:

An overseas buyer approaches an Indian exporter requesting a three-month extension on the payment due date because of a temporary liquidity crunch. The export bill is insured under a standard policy. To prevent the policy from being voided, what procedural step must the exporter follow?

- (A) Refuse the extension and immediately launch legal action in the buyer's country.
- (B) Request an Export Performance Indemnity from the exporter's bank.
- (C) Obtain prior approval of the insurer before extending the export bill's due date.
- (D) Convert the transaction to Maturity Factoring immediately.

Oct/Nov 2020

40. Read the following scenario and answer the question that follows:

An exporter has a continuous, long-standing relationship with a buyer, dealing strictly on open account terms. The exporter suddenly receives a massive bulk order and faces a severe working capital shortfall. The exporter wants full credit protection, maintenance of the sales ledger, and an immediate advance up to 90% without routing bills through a commercial bank. Which service perfectly matches this requirement?

- (A) Maturity Factoring
- (B) WT-PC Insurance
- (C) Export Production Finance Guarantee
- (D) Transfer Guarantee

May/June 2022

41. Which of the following pairs of products for banks and their descriptions is INCORRECTLY matched?

- (A) Export Finance Guarantee – Covers advances given by banks against incentives at the pre-shipment stage.
- (B) ECIB (WT-PC) – Packing Credit Insurance covering advances at the pre-shipment stage.
- (C) ECIB (WT-PS) – Post-Shipment Export Credit Insurance covering advances against export documents.
- (D) Export Performance Indemnity – Counter guarantee to the bank against possible losses on guarantees issued on behalf of exporters.

Oct/Nov 2023

42. Which of the following best defines the concept of 'risk' in the context of commercial and business activities?

- (A) An absolute certainty of financial loss due to mismanagement of affairs.
- (B) An uncertain event with financial consequences resulting in loss or reduced earnings.
- (C) A predictable fluctuation in foreign exchange rates directly impacting profit margins.
- (D) An inherent flaw in the production process leading to guaranteed operational failure.

May/June 2016

43. Consider the following statements regarding the 'Small Exporters' Policy':

- (B) Standard short-term policies issued exclusively to protect small exporters against exchange fluctuations.
- (C) Policies aimed at indemnifying banks against defaults on post-shipment advances for up to 180 days.
- (D) Policies protecting exporters against payment risks in specific contracts, such as turnkey projects.

May/June 2020

69. Read the following scenario and answer the question that follows:
An exporter secures a confirmed letter of credit (LC) from an overseas bank for a specific shipment. The exporter is confident about the financial stability of the buyer and the LC opening bank but is concerned about a sudden change in the foreign government's remittance laws blocking the payment. Which specific short-term policy should the exporter avail to cover this exact scenario optimally?
- (A) Contracts (Comprehensive Risks) Policy
 - (B) Specific Shipments (Insolvency and Default) Policy
 - (C) Export Turnover Policy
 - (D) Shipment (Political Risks) Policy

Oct/Nov 2015

70. Which of the following scenarios is the most appropriate use case for an Export Performance Indemnity?
- (A) A bank extends a foreign currency loan to an overseas contractor and requires protection against non-payment.
 - (B) An exporter demands protection against the insolvency of an LC opening bank located in a high-risk country.
 - (C) An exporter requires a counter guarantee to a bank against a bid-bond guarantee issued in favour of an overseas buyer.
 - (D) An exporter ships goods to a stock-holding agent and requires cover against physical damage to the inventory.

May/June 2013

71. Read the following scenario and answer the question that follows:
An exporter opts for the Exchange Fluctuation Risk Cover Scheme. During the payment period, the exchange rate moves unfavourably, resulting in a total exchange loss of 15% against the reference

rate. How will this 15% loss be distributed between the exporter and the insurer?

- (A) The insurer bears the entire 15% loss because it falls within the 35% scheme threshold.
- (B) The exporter bears the first 2% loss, and the insurer makes good the remaining 13%.
- (C) The insurer bears the first 2% loss, and the exporter bears the entire remaining 13%.
- (D) The exporter and the insurer share the total 15% exchange loss on an equal 50/50 basis.

Oct/Nov 2021

72. Arrange the following institutional and policy milestones in the evolution of export credit insurance in India in chronological order:
- I. Introduction of the Policy exclusively for the SME sector units
 - II. Transformation into Export Credit Guarantee Corporation Ltd.
 - III. Establishment of Export Risks Insurance Corporation (ERIC)
 - IV. Rechristening of the SME policy as Micro Exporters Policy (MEP)
- (A) III, II, I, IV
 - (B) I, III, II, IV
 - (C) III, I, IV, II
 - (D) II, III, I, IV

May/June 2024

73. Read the following scenario and answer the question that follows:
A bank settles a claim under the WT-PS guarantee for an export bill, where the insurer covered 65% of the outstanding advance. Later, the bank successfully realizes Rs. 1,000,000 from collateral securities attached to the defaulting exporter. How much of this recovered amount must the bank refund to the insurer?
- (A) Rs. 350,000
 - (B) Rs. 500,000
 - (C) Rs. 650,000
 - (D) Rs. 1,000,000

Oct/Nov 2008

74. Match the types of risks in international trade in List I with their corresponding descriptions in List II:
- List I: (Type of Risk)
- P. Credit Risk
 - Q. Legal Risk
 - R. Country Risk
 - S. Operational Risk

provided they maintain sufficient premium deposits and compliance.

18. (A) I, II, III, and IV

Transfer Guarantees protect banks that confirm foreign letters of credit against the risk of the foreign bank failing to reimburse payments. This guarantee applies when the bank binds itself to honor drafts drawn by the beneficiary without recourse. It specifically covers political and commercial risks associated with the foreign bank, provided all terms of the credit are strictly met.

19. (A) The extent of cover and premium are identical to those applied under post-shipment export credit insurance.

The Export Production Finance Guarantee is designed to protect banks against losses on pre-shipment advances made against incentives or receivables. Unlike the suggestion that its extent of cover and premium are identical to post-shipment insurance, this specific guarantee has its own unique structure and pricing, though banks with whole turnover packing credit insurance may receive concessional premium rates.

20. (A) I, II, III, and V

Political risks covered under standard policies include war, revolution, and civil disturbances in the buyer's country, along with new import licensing restrictions. They also cover additional freight costs from interrupted voyages and other external causes beyond the control of both parties. However, protracted default by the buyer is classified as a commercial risk, not a political risk, in insurance.

21. (D) Settlement of the claim amount relieves the exporter of the responsibility of realizing proceeds.

In the handling of claims, settlement of the claim amount by the insurer does not relieve the exporter of the responsibility to realize the proceeds. The exporter must continue efforts to recover the debt and must share any subsequent recoveries with the insurer. Additionally, the insurer does not limit settlements to only four buyers during a single policy period.

22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Export credit insurance indeed lowers the cost of borrowing for exporters because the insurer assumes the default risk on a shared basis. This reduction in risk allows financing banks to lower the risk premium they charge on loans. Therefore, the assertion is true, and the reason correctly explains why the insurance leads to more affordable financing for the exporter.

23. (B) Failure of the exporter to fulfil the terms of the export contract

Standard credit insurance policies are designed to cover external risks such as new import restrictions, interrupted voyages, and buyer insolvency. However, they specifically exclude losses that arise from the exporter's own failure to fulfill the terms and conditions of the export contract. Insurance is intended to protect against buyer and country risks, not the seller's operational non-performance.

24. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Financial guarantees for banks require an upfront premium payment, often based on the previous year's average, to ensure continuous coverage. These insurance products are regulated by authorities and must adhere to standard general insurance guidelines. Thus, the assertion regarding upfront payment is true, and the reason regarding regulatory compliance and standard practices correctly explains the necessity of this arrangement.

25. (A) Commercial risks of the joint venture failing Overseas Investment Insurance provides protection against non-commercial risks such as expropriation, restrictions on remittances, and war or civil disturbances in the host country. It specifically does not cover the commercial risks associated with the failure of the joint venture or project itself. Investors must bear the standard business risks while being protected against foreign political and legal uncertainties.

- (B) The bank is considered entirely uninsurable under any standard credit insurance policy.
- (C) The exporter is required to shift the transaction to a standard Export Turnover Policy.
- (D) The exporter must obtain specific insurer approval prior to making the actual shipment.

Oct/Nov 2012

80. Which of the following pairs correctly identifies two specific policies available for covering consignment exports?
- (A) Consignment Exports (Overseas Branch) AND Consignment Exports (Third-Party Agent)
 - (B) Consignment Exports (Wholly Owned Subsidiary) AND Consignment Exports (Stock-holding Agent)
 - (C) Consignment Exports (Direct Entity Policy) AND Consignment Exports (Global Entity Policy)
 - (D) Consignment Exports (Stock-holding Agent) AND Consignment Exports (Global Entity Policy)

- 52.** (D) The cover provided is not for 100% of the value, requiring the exporter or bank to bear a part of the loss.
The concept of a risk-sharing basis means the insurer does not provide one hundred percent indemnity for losses. Instead, the exporter or the financing bank must bear a small portion of the loss, typically between five and fifteen percent. This ensures that the policyholder maintains an interest in the transaction and continues to exercise due diligence in buyer and country selection.
- 53.** (B) I, II, and IV
The Export Turnover Policy is intended for large exporters paying at least ten lakh rupees in annual premiums. It offers premium discounts for exceeding turnover targets and requires a validity period of one year. However, it provides higher discretionary credit limits rather than lower ones, allowing these major exporters more flexibility in managing their overseas buyer limits without needing constant individual approvals.
- 54.** (C) Banks can adopt the country risk classifications published by authorized credit guarantee corporations.
Country risk assessment is a vital part of international trade, focusing on the political and economic stability of a nation. Banks are permitted to adopt country risk classifications published by authorized credit guarantee corporations for their provisioning requirements. These agencies categorize countries based on various factors, providing a standardized framework for banks to manage their exposure to different international markets.
- 55.** (B) I, II, and IV
Overseas Investment Insurance covers equity and untied loans for expanding projects, whether in cash or Indian capital goods. It is best supported by bilateral investment protection agreements. However, the third statement is incorrect because the scheme is specifically designed to cover political and non-commercial risks like expropriation, not the commercial risks associated with the joint venture's business success or failure.
- 56.** (A) The declaration must show total amounts financed during the month and products thereof along with the premium.
Banks holding whole turnover insurance are required to submit monthly declarations that detail the total amounts financed during that period. These declarations must include the products financed and the corresponding premium due. This regular reporting ensures that the insurer has an accurate record of the bank's exposure and that all financed transactions are adequately covered under the global policy terms.
- 57.** (A) I, II, IV, and V
Standard credit insurance policies specifically exclude risks inherent in the nature of goods, exchange rate fluctuations, and defaults by collecting banks. Furthermore, losses arising from the exporter's failure to fulfill contract terms are not covered. While blockages of payment by the buyer's government are covered as political risk, the other listed items are considered outside the scope of standard protection.
- 58.** (B) It encompasses the risk of an overseas buyer going bankrupt due to massive currency devaluation.
Operational risk involves disruptions in the production or delivery process, such as strikes at factories, staff errors, or communication failures. It is incorrect to classify a buyer's bankruptcy due to currency devaluation as an operational risk. Such an event falls under commercial or country risk, as it relates to the buyer's financial capacity rather than the efficiency of business operations.
- 59.** (D) I, II, III, IV, and V
A factoring service offers a comprehensive suite of facilities, including the purchase of account receivables and providing up to ninety percent finance against approved transactions. It also handles sales ledger maintenance, follows up for the collection of export proceeds, and provides a full credit guarantee in the event of buyer default or insolvency. This ensures both liquidity and risk protection.
- 60.** (C) Discretionary Limits apply solely to specific shipment policies and are invalid for financial guarantees issued to banks.
Discretionary limits allow banks to finance transactions up to a certain amount without

9. (C) 90%

The Micro Exporters Policy, designed for the SME sector, provides an enhanced extent of cover compared to standard policies. To support smaller businesses in international markets, this policy offers protection up to ninety percent of the loss. This higher coverage level helps mitigate the financial impact of buyer defaults or political events on smaller, vulnerable export units.

10. (D) I, II, and III

Customer Specific Policy Covers are designed for large exporters with annual premiums exceeding ten lakh rupees. These tailored policies are issued on a selective basis to meet unique requirements not covered by standard products. They often integrate various features from existing policies, providing a flexible and comprehensive risk management tool for exporters with complex, high-volume international trade operations.

11. (A) The government agency bears the risk of default, providing protection that enhances the creditworthiness of the transaction.

Export credit insurance significantly lowers borrowing costs because the government-backed agency assumes a major portion of the risk of default. This protection enhances the creditworthiness of the exporter's transactions in the eyes of financial institutions. Banks, facing reduced risk, are more willing to provide financing at competitive interest rates, as the insurance acts as a secondary security.

12. (B) I, III, and IV

Short-term standard policies cover buyer insolvency, failure to pay within a specified period after the due date, and failure to accept goods under specific conditions. However, commercial disputes regarding the quality of goods are generally excluded unless the exporter obtains a favorable decree from a competent court of law in the buyer's country for settlement.

13. (B) Open cover has no political risk limits, whereas restricted cover requires case-by-case approvals.

The conceptual difference between open cover and restricted cover countries lies in the political risk limits. Open cover countries have no specific political risk limits, allowing for more fluid transactions. In contrast, restricted cover

countries require case-by-case approvals and specific limits, as they present higher risks that necessitate closer scrutiny and more controlled insurance coverage for exporters.

14. (A) I, II, and III

The Exchange Fluctuation Risk Cover Scheme applies to payments scheduled between one and fifteen years. It features a two percent deductible, where the insurer covers losses exceeding that threshold up to a maximum of thirty-five percent of the reference rate. The fourth statement is incorrect because gains or losses beyond the thirty-five percent cap do not exclusively benefit the exporter.

15. (D) A higher percentage of cover is available at a lower premium since a large volume of business is offered.

Whole Turnover Packing Credit insurance allows banks to offer higher percentages of cover at lower premium rates. This is possible because the large volume of business provided to the insurer reduces individual risk concentration. While premium costs are often passed to exporters, the primary benefit is the bank's ability to extend pre-shipment advances with significantly enhanced security and reduced costs.

(A) I, II, and III

Exporters must ensure shipments are covered by valid credit and loss limits and obtain specific approval for proceeds from restricted cover countries. They are also required to submit monthly shipment declarations by the fifteenth. However, filing claims within 360 days of shipment is incorrect; the deadline is actually calculated based on the due date of the unpaid bill.

17. (B) It provides for higher discretionary credit limits on overseas buyers, based on the total premium paid.

The Export Turnover Policy is designed for large exporters, providing them with higher discretionary credit limits on overseas buyers. These limits are typically determined based on the total premium paid by the exporter. This flexibility allows businesses to manage higher-value transactions more efficiently without seeking individual approvals for every shipment,

ANSWERS

1. (B) At the risk and on behalf of the principal exporter.
Under the Consignment Exports (Stock-holding Agent) policy, the Indian exporter retains ownership of the merchandise while it is held in stock by an overseas agent. Consequently, any loss resulting from unexpected events, such as localized destruction, remains at the risk and on behalf of the principal exporter until the goods are sold.
2. (C) Maximum loss portion made good by the insurer – Exceeding 2% but not exceeding 50% of the reference rate
In the Exchange Fluctuation Risk Cover Scheme, the insurer makes good the portion of the loss that exceeds two percent but does not exceed thirty-five percent of the reference rate. Stating that the limit reaches fifty percent is inaccurate. This scheme is specifically designed for long-term projects and deferred payment contracts to mitigate currency volatility.
3. (A) Risks arising from amendments in national laws, such as trade embargoes or export bans.
Legal risk in international trade refers to potential losses stemming from changes in laws or regulations. This includes the sudden imposition of trade embargoes, export bans, or amendments to national legislation that prevent the fulfillment of contracts. It is distinct from credit or operational risks, focusing purely on the legislative environment affecting trade transactions globally.
4. (A) I only
The IT-Enabled Services (Single Customer) Policy provides coverage for one specific buyer for a period of twelve months, covering up to eighty percent of potential losses. While the first statement is correct, the second is false because premium is generally payable based on the approved loss limit or projected volume, not strictly on actual shipments.
5. (D) A tailored policy for large value exporters combining various features of standard policy types.
Customer Specific Policy Covers are highly customized insurance products designed for large exporters whose specific requirements are not fully met by standard, off-the-shelf policies. These tailored solutions can combine features from multiple standard policy types to provide comprehensive protection for high-value transactions and specialized export needs, ensuring flexibility and adequate coverage for significant volumes.
6. (A) I only
For Whole Turnover Post-shipment insurance, the extent of cover for non-policyholders is determined by the bank's claim-premium ratio, typically ranging between fifty and seventy-five percent. However, the second statement regarding a sixty percent coverage for associates of non-policyholders is incorrect, as different parameters or exclusions apply to transactions involving associates in these specific bank guarantees.
7. (B) 1.0%
Regulatory guidelines mandate that banks must make provisions for country risk when their net exposure to a single country equals or exceeds one percent of their total assets. This threshold ensures banks maintain financial stability against external shocks. Exposure below this percentage does not require specific provisioning, though it must still be monitored and reported regularly.
8. (A) I and II only
The Buyer Exposure Policy offers protection against commercial and political risks for transactions with a specific buyer, covering both letter of credit and non-letter of credit terms for twelve months. However, coverage for failure of a letter of credit opening bank is not universal; it is restricted to banks with specific global rankings unless prior approval is obtained.

- 26.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Commercial disputes regarding the quality of goods are generally excluded from short-term policy coverage because the insurer cannot verify the claim without objective evidence. Therefore, exporters must obtain a decree from a competent court in the buyer's country to prove the dispute was unjustified. This requirement ensures that only legitimate credit losses, and not product quality issues, are compensated.

- 27.** (A) Forward covers, futures, and foreign currency accounts

To mitigate direct exchange risk in international trade, businesses typically utilize financial instruments such as forward covers and futures, or maintain foreign currency accounts. These tools allow exporters to lock in exchange rates or hedge against currency fluctuations. Bank guarantees and insurance policies, while useful for credit risk, do not directly address the volatility of foreign exchange markets themselves.

- 28.** (B) The bank can appropriate the claim amount directly to the post-shipment advance account, if any.

When a bank receives a claim amount directly from the insurer for handled export documents, it is permitted to appropriate those funds to the exporter's post-shipment advance account. This ensures that the bank's outstanding credit is settled. Any subsequent recovery from the buyer must then be shared between the bank and the insurer according to the agreed risk-sharing ratio.

- 29.** (D) To ensure the policy covers the premium that will become payable for future shipments to be effected.

Maintaining a sufficient advance premium deposit is a mandatory requirement for exporters to ensure that their policy remains active and covers future shipments. The premium for each shipment is deducted from this deposit. Without an adequate balance, subsequent exports may not be covered, leaving the exporter vulnerable to risks if a loss occurs before the next premium payment is processed.

- 30.** (C) II, IV, I, III

For financial guarantees, the correct chronological sequence of compliance involves the arrival of the due date or date of recall first. This is followed by the bank submitting a notice of default to the insurer. Subsequently, the formal claim must be lodged. Finally, any recoveries from collateral are shared, and a refund is issued based on the risk-sharing ratio.

- 31.** (B) P-4, Q-3, R-2, S-1

Shipment policies cover risks from the date of shipment, while contract policies provide coverage from the date the contract is signed. Comprehensive risk policies cover both commercial and political risks, whereas political risk policies exclude commercial defaults. Therefore, Specific Shipment (Comprehensive) maps to shipment/both, and Specific Contracts (Political) maps to contract/political risks only, following the logical structure of insurance products.

- 32.** (B) P-3, Q-1, R-2, S-4

The Micro Exporters Policy provides ninety percent cover, while standard policies generally offer ninety percent coverage for shipments. Factoring services typically provide up to ninety percent finance against approved transactions. For the Buyer Exposure Policy, the automatic coverage for letter of credit opening banks is limited to those with a global ranking up to twenty-five thousand, requiring specific approval for others.

- 33.** (B) High Risk – C2

Country risk classifications use specific grades to denote the level of risk associated with different nations. In this system, High Risk is correctly matched with the category grade C2. Other grades like A2 represent lower risks, while D represents very high risk. These classifications help banks and insurers determine the appropriate provisioning and insurance terms for international trade transactions.

- 34.** (C) Operational Risk

The delay in shipments due to a labour strike at a supplier's factory is categorized as an operational risk. This classification covers internal or external events that disrupt the production or delivery process, such as strikes, staff errors,

List II: (Description)

1. Arises due to strikes at the transporter's end or communication disruptions.
2. Relates to the inability of the seller to export due to embargoes.
3. Arises from discordant relationships between nations or fluid political situations.
4. Results in non-payment of export bills due to financial crunch or insolvency.

- (A) P-4, Q-2, R-3, S-1
 (B) P-1, Q-4, R-2, S-3
 (C) P-3, Q-1, R-4, S-2
 (D) P-2, Q-3, R-1, S-4

May/June 2006

75. Read the following scenario and answer the question that follows:

An exporter has an unpaid bill with a due date of March 31, 2023. The exporter submits the overdue declaration on time but delays the final claim form submission. According to standard guidelines, what is the absolute deadline for the exporter to submit the claim form for this unpaid bill?

- (A) September 30, 2023
 (B) December 31, 2023
 (C) March 31, 2024
 (D) March 31, 2025

Oct/Nov 2017

76. Match the insurance products for banks in List I with their correct descriptions in List II:

List I: (Insurance Product)

- P. Export Production Finance Guarantee
 Q. Export Credit Insurance for Banks (WT-PS)
 R. Export Performance Indemnity
 S. Export Finance Guarantee

List II: (Description)

1. Issued in the nature of a counter guarantee against guarantees issued by banks for overseas buyers.
2. Covers post-shipment advances granted against export incentives receivables like duty drawback.
3. Protects banks against losses in extending post-shipment advances due to protracted default or insolvency of the exporter.
4. Covers advances given by banks against incentives/receivables at the pre-shipment stage.

- (A) P-4, Q-3, R-1, S-2
 (B) P-1, Q-4, R-2, S-3

(C) P-3, Q-1, R-4, S-2

(D) P-2, Q-3, R-1, S-4

May/June 2008

77. Read the following scenario and answer the question that follows:

Company XYZ has an anticipated annual premium payment to the insurer of Rs. 12 lakhs based on its projected export volume. The company wants a policy that offers simplified premium remittance, an additional discount for exceeding projected turnover, and higher discretionary credit limits. Which policy is specifically tailored for Company XYZ's profile?

- (A) Specific Shipment (Contracts) Policy
 (B) Export Turnover Policy
 (C) Small Exporters Policy
 (D) Consignment Exports (Global Entity) Policy

Oct/Nov 2013

78. Match the related acronyms or limits in List I with their specific functional meaning in List II:

List I: (Acronym or Limit)

- P. DL
 Q. SITES
 R. NCB
 S. SAL

List II: (Functional Meaning)

1. Single Customer policy for service contracts
2. List of borrowers requiring prior approval from the insurer
3. Limit up to which banks can allow finance without prior approval
4. Discount on premium subject to no claims being lodged

- (A) P-3, Q-1, R-4, S-2
 (B) P-1, Q-4, R-2, S-3
 (C) P-2, Q-3, R-1, S-4
 (D) P-4, Q-2, R-3, S-1

May/June 2015

79. Read the following scenario and answer the question that follows:

An exporter holding a Buyer Exposure Policy receives a Letter of Credit (LC) from a foreign bank. The exporter wishes to be covered against the failure of this LC opening bank. The exporter checks the Banker's Almanac and finds the bank's World Ranking (WR) is 28,000. What is the implication for the exporter's coverage?

- (A) The bank is automatically covered because its ranking is below the 50,000 threshold.

43. (A) I only

A Small Exporter is defined as an individual or entity whose projected total export turnover for the upcoming twelve months does not exceed five hundred lakh rupees. The policy specifically designed for them covers shipments made within this period. The second statement is incorrect because the policy's validity and coverage window are not extended to twenty-four months, but remain aligned with the turnover projection.

44. (C) Provision of financing and receivable collection with a full buyer default credit guarantee.

Maturity Factoring is characterized by the provision of financing and receivable collection combined with a full credit guarantee against buyer default. This service allows exporters to receive up to ninety percent of the invoice value as an advance while the factor handles the sales ledger and collection efforts. It provides a complete solution for credit protection and liquidity for continuous trade relationships.

45. (A) I only

Maturity Factoring is specifically designed for exporters who maintain continuous relationships with buyers and conduct business on open account or documents against acceptance terms. This arrangement allows for efficient ledger management and credit protection. The second statement is incorrect because factoring is generally not suitable for one-off counter-trade transactions, which involve the exchange of goods rather than standard receivable financing.

46. (A) 1957

The Export Risks Insurance Corporation was established in India in 1957 to provide credit insurance to exporters. This was a significant milestone in supporting the nation's international trade by protecting against commercial and political risks. Later, in 1964, it was transformed into the Export Credit Guarantee Corporation of India to further expand its support for exporters and financing banks.

47. (A) I and II only

Export credit agencies aim to facilitate the availability of bank finance at competitive rates and provide exporters with vital information about the creditworthiness of buyers and

countries. While they assume a significant portion of the risk, they do not provide one hundred percent coverage. Maintaining a risk-sharing basis ensures that exporters remain diligent in their business dealings and credit assessments.

48. (D) 20 years

Under the Overseas Investment Insurance scheme, the period of insurance cover can be extended for a significant duration to match the long-term nature of foreign projects. The maximum period allowable is twenty years from the date of the commencement of the investment. This provides long-term security for Indian companies investing in equity or untied loans for setting up overseas ventures.

49. (A) I and II only

Buyer's Credit allows overseas buyers to finance the import of Indian machinery for specific projects. The scheme provides ninety percent coverage for commercial risks associated with these transactions. However, a Line of Credit is typically extended to foreign governments or financial institutions to facilitate multiple imports from India, rather than being restricted exclusively to individual retail importers for consumer goods.

50. (C) Seller risk involves buyer-side delays or poor quality, while buyer risk involves non-payment.

Seller risk and buyer risk are distinguished by which party's actions cause the issue. Seller risk involves internal failures, such as shipping delays, poor product quality, or failure to meet contract terms. In contrast, buyer risk primarily concerns the inability or refusal of the purchaser to pay for the goods received, often due to insolvency, financial crunch, or protracted default.

51. (A) I and II only

The Consignment Exports policy requires shipments to be made under a valid agency agreement with an independent overseas entity that has no associate relationship with the exporter. While the agent holds the stock, the principal exporter remains liable for the risks until the goods are sold. The third statement is incorrect because the agent does not assume the absolute risk.

or communication failures. It is distinct from credit risk or political risk, as it focuses on the operational efficiency of the supply chain.

35. (C) 90% to 95%

For a bank holding a Whole-turnover Post-shipment insurance policy where the exporter is an existing policyholder, the extent of cover is significantly higher. Depending on the bank's claim-premium ratio, the insurer typically provides coverage ranging from ninety to ninety-five percent. This high level of indemnity protects the bank against protracted defaults while encouraging the financing of established exporters.

36. (D) Filing notice by May 1st; Filing claim by Nov 1st.

According to standard guidelines for financial guarantees, a notice of default must be filed within four months from the due date of recall. Subsequently, the actual claim must be filed within six months of the notice filing. If the due date is January 1st, the notice is due by May 1st, and the claim must be lodged by November 1st.

37. (C) The exporter must secure prior approval from the insurer.

Exporters must obtain prior approval from the insurer before accepting a settlement offer that involves a discount on the invoice value from a buyer in financial distress. Failure to secure this approval can void the insurance policy coverage for that transaction. The insurer needs to evaluate the request to ensure the settlement is reasonable and minimizes the potential claim amount.

38. (D) The insurer will settle claims for a maximum of four buyers during the policy period.

Under the Small Exporter Policy, operational rules limit the number of buyers for whom claims can be settled during a single policy period. In a scenario where an exporter faces defaults from six different buyers, the insurer will generally only settle claims for a maximum of four buyers, as per the policy terms for this category. This policy helps manage the insurer's aggregate exposure to any single policyholder's portfolio.

39. (C) Obtain prior approval of the insurer before extending the export bill's due date.

When a buyer requests an extension on a payment due date, the exporter must obtain prior approval from the insurer before granting the request. This procedural step is essential to keep the insurance policy valid. Without the insurer's consent, any subsequent loss may not be covered, as the extension changes the risk profile originally agreed upon when the policy was issued.

40. (A) Maturity Factoring

Maturity Factoring is the ideal service for exporters requiring full credit protection, sales ledger maintenance, and collection services without routing bills through a commercial bank. It provides an immediate advance of up to ninety percent against approved transactions. This comprehensive solution allows exporters to manage continuous relationships on open account terms while securing working capital and protecting against potential buyer defaults.

41. (A) Export Finance Guarantee – Covers advances given by banks against incentives at the pre-shipment stage.

The Export Finance Guarantee is incorrectly described because it actually covers post-shipment advances granted by banks against export incentives or receivables, such as duty drawbacks. It does not cover pre-shipment advances. Pre-shipment risks are generally handled under packing credit insurance or the Export Production Finance Guarantee, making the association with pre-shipment incentives in this context functionally incorrect for this product.

42. (B) An uncertain event with financial consequences resulting in loss or reduced earnings.

In commercial and business contexts, risk is defined as an uncertain event with potential financial consequences that can lead to losses or reduced earnings. It encompasses various possibilities, from market fluctuations to buyer defaults. Unlike an absolute certainty of loss, risk involves the probability of negative outcomes, which businesses must identify, assess, and manage through various strategies and insurance tools.

seeking the insurer's prior approval, provided they report the details in the prescribed format. The statement that these limits are invalid for financial guarantees is incorrect. These limits are a fundamental feature of bank guarantees, enabling financial institutions to manage routine export financing efficiently within pre-set parameters.

61. (A) I, III, IV, and V

The Buyer Exposure Policy covers commercial and political risks for specific buyers over twelve months and includes coverage for letter of credit opening banks with a world ranking up to twenty-five thousand. Exporters can exclude these shipments from their standard policy. The second statement is incorrect because the standard issuance period is twelve months, not twenty-four months, for this policy type.

62. (C) The physical distance between the importing and exporting seaports

Reviewing country risk involves assessing economic and political indicators such as exchange rate volatility, Gross Domestic Product, and the Balance of Payments. These factors determine a nation's ability to meet its international obligations. The physical distance between the importing and exporting seaports, while relevant for logistics and shipping costs, is not a factor used to determine a country's risk classification.

63. (C) Assertion (A) is true, but Reason (R) is false. Standard policies exclude losses caused by a buyer's failure to obtain necessary import or exchange authorizations because these are considered the buyer's responsibility. The assertion is true, but the reason is false because these policies cover many legal and political risks originating outside the exporter's home country, including government-imposed payment blockages and new licensing restrictions in the buyer's nation.

64. (D) The policy is exclusively issued with a mandatory validity period of 36 months. The Micro Exporters Policy provides administrative convenience and ninety percent coverage for small and medium enterprises. However, it is incorrect to state that the policy is exclusively issued with a mandatory validity

period of thirty-six months. Like most standard short-term policies, it is typically issued for a twelve-month period to align with annual turnover projections and periodic renewals.

65. (D) Assertion (A) is false, but Reason (R) is true. Insurers do not provide unlimited political risk cover for restricted cover countries; instead, they require specific approvals for each case. The assertion is false because limits are strictly enforced. The reason is true, as approvals for these countries are typically given on merit with a six-month validity, allowing the insurer to monitor the volatile political situation and manage aggregate exposure.

66. (C) Ensure independent settlements are negotiated with defaulting buyers without insurer interference.

Exporters are responsible for maintaining sufficient policy liability limits, obtaining approvals for restricted cover countries, and filing claims within the required timeframe. However, negotiating independent settlements with defaulting buyers without insurer interference is not a responsibility. In fact, most policies require the exporter to consult with the insurer before agreeing to any settlement terms to ensure the claim remains valid.

67. (A) Exchange Risk

When the Indian Rupee strengthens against the US Dollar after a shipment is invoiced but before payment is received, the exporter faces exchange risk. This risk stems from fluctuations in currency values, leading to a reduction in the Rupee value of the proceeds. This financial loss is a direct result of market volatility and is distinct from country or operational risks.

68. (D) Policies protecting exporters against payment risks in specific contracts, such as turnkey projects.

Specific Shipment Policies are designed to protect exporters against payment risks in specific, high-value contracts rather than a whole turnover basis. These are often utilized for large-scale projects, such as turnkey or construction works, where the duration and risk profile differ from routine shipments. They provide tailored indemnity against commercial and political defaults for the duration of the specific contract.

69. (D) Shipment (Political Risks) Policy

The Shipment (Political Risks) Policy is the optimal choice for an exporter who is confident in the buyer and the bank but fears sudden changes in government laws, such as remittance blockages. This policy specifically isolates political risks, providing targeted coverage against sovereign actions that prevent the transfer of funds, without requiring the exporter to pay for commercial risk protection.

70. (C) An exporter requires a counter guarantee to a bank against a bid-bond guarantee issued in favour of an overseas buyer.

An Export Performance Indemnity is used when an exporter needs a counter-guarantee for a bank. This occurs when the bank issues guarantees, such as bid-bonds or performance bonds, in favor of overseas buyers. The indemnity protects the bank against potential losses if the exporter fails to fulfill the guaranteed obligations, thereby facilitating the issuance of these necessary trade instruments.

71. (B) The exporter bears the first 2% loss, and the insurer makes good the remaining 13%.

Under the Exchange Fluctuation Risk Cover Scheme, the exporter bears the initial two percent of any exchange loss as a deductible. The insurer then makes good the remaining portion of the loss, up to the thirty-five percent limit. In this scenario, with a total fifteen percent loss, the exporter pays the first two percent, and the insurer covers the remaining thirteen percent.

72. (A) III, II, I, IV

The evolution of export credit insurance in India began with the establishment of the Export Risks Insurance Corporation in 1957. This was followed by its transformation into the Export Credit Guarantee Corporation in 1964. Much later, the policy for SME sector units was introduced, which was eventually rechristened as the Micro Exporters Policy to better serve small-scale international traders.

73. (C) Rs. 650,000

When a bank realizes funds from collateral after receiving a claim payment, it must refund the insurer based on the original risk-sharing ratio. Since the insurer covered sixty-five percent of the advance, the bank must return sixty-five percent

of any subsequent recovery. Therefore, from a ten lakh rupee recovery, the bank must refund six lakh fifty thousand rupees to the insurer.

74. (A) P-4, Q-2, R-3, S-1

Credit risk involves non-payment due to buyer insolvency or financial crunch. Legal risk relates to the inability to export due to embargoes or law changes. Country risk arises from political instability or discordant relations between nations. Operational risk includes disruptions like strikes at transporters or staff errors. Matching these definitions helps exporters identify and manage the various threats in international trade.

75. (C) March 31, 2024

According to standard credit insurance guidelines, the absolute deadline for an exporter to submit a formal claim form is twelve months from the original due date of the unpaid bill. If a bill was due on March 31, 2023, the exporter must ensure the claim is lodged by March 31, 2024. Failure to meet this deadline may result in claim rejection.

76. (A) P-4, Q-3, R-1, S-2

The Export Production Finance Guarantee covers pre-shipment advances against incentives. Whole Turnover Post-Shipment insurance protects banks against exporter default on advances made against export documents. Export Performance Indemnity acts as a counter-guarantee for bank-issued guarantees for overseas buyers. Finally, the Export Finance Guarantee covers post-shipment advances specifically granted against incentives or duty drawbacks like receivables.

77. (B) Export Turnover Policy

The Export Turnover Policy is specifically tailored for large exporters like Company XYZ with an annual premium exceeding ten lakh rupees. It provides the required administrative convenience of simplified premium remittance and offers incentives like discounts for exceeding turnover targets. Additionally, it grants higher discretionary credit limits, enabling the company to manage large volumes of overseas buyers more efficiently and independently.

78. (A) P-3, Q-1, R-4, S-2

DL stands for Discretionary Limit, the threshold for bank-authorized finance without prior insurer

approval. SITES refers to the single-customer policy for service contracts. NCB is the No Claim Bonus, a premium discount for claim-free periods. SAL represents the Specific Approval List, which contains borrowers that require the insurer's prior consent before any financing can be extended by the bank.

- 79.** (D) The exporter must obtain specific insurer approval prior to making the actual shipment. For a Buyer Exposure Policy, the automatic coverage for a letter of credit opening bank is restricted to those with a World Ranking up to twenty-five thousand. Since the bank in this scenario has a ranking of twenty-eight thousand, it falls outside the automatic limit. Therefore, the exporter must obtain specific approval from the insurer before proceeding with the shipment.
- 80.** (D) Consignment Exports (Stock-holding Agent) and Consignment Exports (Global Entity Policy) Consignment exports can be covered under two specific policy types: the Consignment Exports (Stock-holding Agent) policy and the Consignment Exports (Global Entity) policy. The first is used when goods are held by an independent agent for future sale, while the second is designed for exporters shipping to their own overseas entities or branches under a more comprehensive global arrangement.

Oct/Nov 2013

36. Match the Regulatory Returns in List I with their corresponding descriptions in List II:

List I: (Regulatory Returns)

P. FETERS

Q. STAT 5

R. STAT 8

S. BAL Statement

List II: (Descriptions)

1. Data on transactions related to FCNRB deposits.
2. Statement showing balances in NOSTRO and VOSTRO accounts.
3. Bank-wide single return of fortnightly data on forex operations.
4. Data on transactions in NRE and NRO deposit accounts.

(A) P-3, Q-1, R-4, S-2

(B) P-1, Q-3, R-2, S-4

(C) P-4, Q-2, R-1, S-3

(D) P-3, Q-4, R-1, S-2

May/June 2015

37. Under the Automatic Route, what is the primary procedural requirement an Indian entity must fulfill through their designated AD Category-I bank to effect remittances towards an overseas investment?

(A) Submit an application to the Ministry of Finance for clearance.

(B) Approach the AD with an application in Form ODI and prescribed enclosures.

(C) Obtain a prior approval letter from the Reserve Bank of India.

(D) Provide a self-declaration to the Customs department at the port of exit.

Oct/Nov 2012

38. Match the export business categories in List I with their Normal Transit Periods under FEDAI rules in List II:

List I: (Export Categories)

P. Bills in Foreign Currencies

Q. Exports to Iraq under United Nations Guidelines

R. Bills drawn in Rupees under L/C with reimbursement provided by banks outside India

S. TT reimbursement under L/C via electronic means

List II: (Normal Transit Periods)

1. Maximum 120 days

2. 5 days

3. 25 days

4. 20 days

(A) P-3, Q-1, R-4, S-2

(B) P-1, Q-3, R-2, S-4

(C) P-2, Q-4, R-1, S-3

(D) P-4, Q-1, R-3, S-2

May/June 2011

39. Following an Overseas Direct Investment (ODI) followed by an Indian entity, what specific document must the Indian entity submit to the Reserve Bank, through the designated AD, every year on or before December 31?

(A) A comprehensive audit of the EEFC account conducted by a certified public accountant or statutory auditor.

(B) A Declaration by the Statutory Auditors of the WOS regarding the net worth of the foreign entity.

(C) An Annual Performance Report (APR) in Part II of Form ODI.

(D) A report on disinvestment by way of voluntary liquidation filed with the Registrar of Companies in India.

Oct/Nov 2020

40. Which of the following pairs of foreign currency accounts and their target account holders is correctly matched?

(A) EEFC Accounts - Returning NRIs settling permanently in India

(B) DDA Accounts - Diamond exporters with two years in export trade

(C) RFC(D) Accounts - Foreign nationals visiting India on a business visa

(D) RFC Accounts - Resident persons earning foreign exchange through trade

May/June 2022

41. According to FEDAI guidelines for the delayed delivery of USD in an interbank transaction, what benchmark rate should be used to calculate the interest payable?

(A) 2% over the Prime rate of Citibank N A

(B) 2% over the FBIL - MIBOR overnight rate

(C) 2% over the Base rate of Barclays Bank

(D) 2% over the Marginal Lending Facility rate of European Central Bank

by choosing a single depository bank to manage local listings.

- (B) An arrangement initiated by the issuing company but executed without any US brokers through direct cross-border share registration processes.
- (C) A depository receipt floated as a public offering on a U.S. exchange to raise capital for the expansion of international operations.
- (D) An arrangement set up by brokers based on market demand where the foreign company has no formal agreement with a depository bank.

May/June 2012

7. Read the following statements regarding the cancellation of foreign exchange contracts under FEDAI rules:

- I. Sale contracts shall be cancelled at the T.T. buying rate of the contracting Authorised Dealer.
- II. When a contract is cancelled after the maturity date, the customer is entitled to receive the exchange difference in his favour.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2014

8. What is the maximum penalty the Reserve Bank of India (RBI) may impose for continuing contraventions of any direction given under the Foreign Exchange Management Act (FEMA)?
- (A) Up to Rs. 10,000.00 in total.
 - (B) Up to Rs. 2,000.00 per day for which such contravention continues.
 - (C) Up to USD 5,000.00 per day for which such contravention continues.
 - (D) Up to Rs. 50,000.00 in total.

May/June 2019

9. Read the following statements regarding the acquisition of foreign currency for travel abroad:
- I. A person resident in India can possess foreign currency coins without any limit.
 - II. While selling foreign exchange for travel abroad, the passport of the traveller must be endorsed in all cases.

- III. Unspent foreign exchange can be deposited in the Resident Foreign Currency Account (RFC).

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2006

10. What is the minimum maturity period required for Foreign Currency Exchangeable Bonds (FCEBs) as per regulatory guidelines?
- (A) 1 year
 - (B) 3 years
 - (C) 5 years
 - (D) 7 years

May/June 2021

11. Read the following statements regarding FEDAI Rule 4 on Encashment and Payment:

- I. Foreign currency travelers' cheques will be encashed at the appropriate buying rate ruling on the date of encashment.
- II. Foreign currency inward remittances up to USD 10,000 shall be immediately converted into Indian Rupees.
- III. Authorised Dealers shall pay compensation for delayed payment at 5% over their savings bank interest rate.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2010

12. What is the primary conceptual purpose of the Diamond Dollar Account (DDA) for diamond exporters?
- (A) To allow exporters to park foreign currency funds and retire import bills without incurring exchange risk.
 - (B) To facilitate the import of polished diamonds by providing foreign currency loans through designated Authorized Dealer Category-I banks.
 - (C) To convert rough diamonds into liquid domestic assets for local trading on the national commodity exchanges and bullion markets.
 - (D) To enable the repatriation of dividend

income from overseas subsidiaries and joint ventures to the Indian parent company's account.

May/June 2005

13. Read the following statements regarding the regulations for Overseas Direct Investment (ODI) by Indian entities:

- I. Real estate and banking business are prohibited sectors for overseas direct investment.
- II. Under the Automatic Route, an Indian Party does not require prior approval from the Reserve Bank.
- III. An Indian Party should not be on the Reserve Bank's Exporters' caution list to be eligible.
- IV. Indian entities are strictly prohibited from offering any personal guarantee by their indirect resident individual promoters.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

Oct/Nov 2022

14. Why do U.S. depository banks often set a specific ratio of ADRs per home-country share rather than a strict 1:1 ratio?

- (A) To comply with the Securities and Exchange Commission's mandate on maximum share prices for foreign companies listing on the New York Stock Exchange.
- (B) To price the ADR high enough to show value, yet low enough to be affordable and avoid penny stock status.
- (C) To guarantee that the dividends paid to investors always exceed the administrative costs borne by the issuing company for maintaining the ADR program.
- (D) To automatically convert the value of foreign shares into euros for European investors trading in the international over-the-counter markets.

May/June 2018

15. Read the following statements regarding the Liberalized Remittance Scheme (LRS) and other remittances:

- I. The LRS scheme is available to corporates, partnership firms, and HUFs.

- II. Gift remittances up to USD 250,000 per financial year to relatives abroad are permitted.

- III. Subscription to banned/proscribed magazines is not allowed.

- IV. Remittance for consultancy services is allowed up to USD 10,000,000 per project for infrastructure projects.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

Oct/Nov 2016

16. Which of the following statements correctly describes the rules for purchasing foreign exchange for travel abroad?

- (A) A resident cannot possess foreign currency coins without obtaining prior RBI approval under the Foreign Exchange Management Act.
- (B) Drawal of exchange for travel to Nepal and Bhutan is permitted up to USD 250,000 per financial year under the current LRS scheme.
- (C) The passport of the traveller must be endorsed in all cases by the Authorized Dealer while selling any amount of foreign exchange.
- (D) Payment in rupees for the purchase of foreign exchange may be done in cash up to Rs. 50,000.

May/June 2014

17. Read the following statements regarding Foreign Currency Convertible Bonds (FCCBs):

- I. They are issued in currencies different from the issuing company's domestic currency.
- II. Under international reporting provisions, a company must mark-to-market the amount of its outstanding bonds.
- III. The price and the yield on the bond move in opposite directions.
- IV. Issuance of FCCBs is completely exempt from Foreign Direct Investment guidelines including sectoral caps.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

Oct/Nov 2007

18. Identify the correct statement regarding FEDAI guidelines on the cancellation of foreign exchange contracts.
- (A) Purchase contracts shall be cancelled at the T.T. buying rate of the contracting Authorised Dealer on the day of request.
 - (B) A matured contract shall be cancelled by the bank on the 3rd working day after the maturity date.
 - (C) Sale contracts shall be cancelled at the T.T. selling rate of the contracting Authorised Dealer on the day of request.
 - (D) When a contract is cancelled after the maturity date, the customer is entitled to the exchange difference in his favour.

May/June 2025

19. Read the following statements regarding FEDAI Rule 8 on Interbank Settlement and Delays:
- I. A seller bank delivering funds to an account other than the notified account of the buyer bank must compensate the buyer.
 - II. The claim for the delay in receipt of funds by the buyer bank should be made within 15 working days.
 - III. If a claim is made after 15 working days, the interest will be payable for a maximum period of 60 days only.
 - IV. The selling bank has 60 working days to settle a claim from the date of receipt without any penalty.
 - V. Deliberate default unresolved within 60 days may be referred to FEDAI for a final binding decision.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV
 - (B) II, III, IV, and V
 - (C) I, II, III, and V
 - (D) I, III, IV, and V

Oct/Nov 2019

20. Which of the following remittances is NOT prohibited under Schedule I of FEMA?
- (A) Remittance for consultancy services for infrastructure projects.
 - (B) Remittance of income from racing or riding.
 - (C) Remittance out of lottery winnings.
 - (D) Payment of commission on exports under Rupee State Credit Route (except up to 10% for tea and tobacco).

May/June 2009

21. Read the following statements regarding the obligations and features of Overseas Direct Investment (ODI):
- I. An Indian Party can make overseas direct investment in any bonafide activity, except real estate and banking.
 - II. A resident Indian individual cannot remit funds under the LRS for setting up a JV/ WOS overseas.
 - III. The Indian Party must repatriate to India all dues receivable from the foreign entity within 60 days of falling due.
 - IV. An Annual Performance Report (APR) in Part II of Form ODI must be submitted every year on or before December 31.
 - V. Investment may be funded by the capitalization of exports.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V
 - (B) I, III, IV, and V
 - (C) II, III, IV, and V
 - (D) I, II, IV, and V

Oct/Nov 2011

22. Identify the incorrect statement regarding Foreign Currency Convertible Bonds (FCCBs).
- (A) They are issued in currencies different from the issuing company's domestic currency.
 - (B) They appear on the liabilities side of the issuing company's balance sheet.
 - (C) A holder of FCCB has the option of either converting it into equity share at a predetermined price or retaining the bonds.
 - (D) The price and the yield on the bond move in the same direction.

May/June 2010

23. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option:
- Assertion (A): The Foreign Exchange Regulation Act (FERA) 1973 was considered much more of a draconian legislation compared to FEMA 1999.
- Reason (R): Any offence under FERA was treated as a non-bailable criminal offence, whereas under FEMA, violations are dealt with under Civil laws only.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of

CHAPTER 08

EXIM Bank, RBI, FEMA, FEDAI and Exchange Control in India

NOBIA

May/June 2016

1. Which of the following pairs regarding the types of Sponsored ADR issues is incorrectly matched?
 - (A) Level 3 - Most basic type of ADR aiming to avoid any public offerings
 - (B) Level 1 - Found on the over-the-counter market with least SEC requirements
 - (C) Level 2 - Listed on an exchange or quoted on Nasdaq
 - (D) Unsponsored ADRs - Often issued by more than one depositary bank without a formal agreement

Oct/Nov 2009

2. If an interbank claim for delayed funds remains unresolved for 60 days from the date of lodgment, what is the next prescribed step under FEDAI rules?
 - (A) The claim is automatically voided and the loss must be written off by the claimant bank immediately.
 - (B) The matter may be referred to FEDAI for a final and binding decision.
 - (C) The matter must be referred to the Reserve Bank of India for formal criminal prosecution of the bank.
 - (D) The equivalent amount may be seized from the defaulting bank's VOSTRO account via a central bank directive.

May/June 2023

3. Which of the following pairs of remittances and their regulatory treatment under FEMA is incorrectly matched?
 - (A) Remittance out of lottery winnings - Prohibited under the current Foreign Exchange Management Act guidelines for residents.
 - (B) Remittance of dividend subject to dividend balancing - Prohibited for companies operating in the consumer goods sector.

- (C) Payment related to "Call Back Services" of telephones - Permitted up to USD 50,000.
- (D) Remittance for purchase of proscribed magazines - Prohibited to ensure compliance with national security and public order laws.

Oct/Nov 2018

4. Under Foreign Exchange Dealers' Association of India (FEDAI) Rules, how is a "known holiday" defined?
 - (A) A holiday which is known at least 3 working days before the date.
 - (B) A holiday that is declared suddenly due to unforeseen circumstances.
 - (C) A holiday that falls on the second and fourth Saturday of every month.
 - (D) A holiday that is published in the annual gazette by the Reserve Bank of India.

May/June 2007

5. Read the following statements regarding Overseas Direct Investment (ODI) out of RFC accounts:
 - I. General permission has been granted to persons resident in India for the purchase of securities out of funds held in their RFC account.
 - II. Proposals covered under this general permission require prior approval of the Reserve Bank through Form ODI.Which of the above statement(s) is/are correct?
 - (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2025

6. What defines an "Unsponsored ADR" (American Depositary Receipt)?
 - (A) An arrangement where the issuing company actively promotes its ADRs in the USA

- (B) Finance for Grass Root Enterprises to help small-scale artisans and rural producers reach international consumer markets.
- (C) Import loans for financing third-country imports for projects to be executed in foreign countries.
- (D) Research & Development Finance for Export Oriented Units to develop new products and processes for global competition.

Oct/Nov 2021

30. What is the most appropriate reason for an Indian corporate to issue Foreign Currency Exchangeable Bonds (FCEBs)?
- (A) To convert existing domestic Rupee loans into foreign currency liabilities automatically upon reaching a specific maturity date.
 - (B) To raise overseas debt by leveraging listed group companies without immediately diluting the issuing company's own equity.
 - (C) To fund the acquisition of real estate properties globally under the automatic route without obtaining prior Reserve Bank approval.
 - (D) To ensure that the bonds can only be redeemed in Indian Rupees at maturity to avoid foreign exchange volatility.

May/June 2024

31. Out of USD 150,000 drawn for a private tour to Europe, what is the maximum amount a resident can obtain in the form of foreign currency notes and coins, assuming no special country exemptions apply?
- (A) USD 2,000
 - (B) USD 3,000
 - (C) USD 5,000
 - (D) The entire amount

Oct/Nov 2008

32. What is the most appropriate procedure for handling a spot contract's date of delivery under FEDAI Rule 5.4?
- (A) It shall be deliverable on the same day of the transaction to facilitate immediate settlement.
 - (B) It shall be deliverable on the working day immediately succeeding the contract date as per standard rules.
 - (C) It shall be deliverable at a future date beyond the spot date based on customer

requirements.

- (D) It shall be deliverable on the second succeeding working day following the contract date.

May/June 2006

33. Upon returning from a private tour abroad, what is the regulatory requirement for a resident regarding unspent foreign exchange?
- (A) It must be surrendered within 90 days from the date of return.
 - (B) It must be surrendered within 180 days from the date of return.
 - (C) An unlimited amount of foreign currency notes can be retained indefinitely.
 - (D) It must be converted into an EEFC account balance immediately upon arrival.

Oct/Nov 2017

34. Arrange the following events related to the handling of an interbank Vostro transfer form A3 delay in the chronological sequence as envisioned under FEDAI Rules:
- I. Time limit of 5 working days expires without receipt of form A3 at beneficiary bank's end.
 - II. Beneficiary bank lodges a claim with the remitting bank within 15 days.
 - III. Bank carrying out interbank Vostro transfer mentions a remark in the RTGS message.
 - IV. Remitting bank pays penalty at Rs. 1000/- per day for the period in excess of 5 days.
- (A) I, II, III, IV
 - (B) III, I, II, IV
 - (C) III, I, IV, II
 - (D) I, III, II, IV

May/June 2008

35. If an export bill submitted was a usance bill where the due dates were fixed and reckoned from the date of shipment, what is the normal transit period applicable to it under FEDAI rules?
- (A) 25 days from the date of acceptance or the date of the bill as per standard rules.
 - (B) 20 days for bills drawn in foreign currencies under letters of credit with immediate reimbursement.
 - (C) Maximum 120 days for exports to Iraq under the specialized United Nations humanitarian guidelines.
 - (D) Normal transit period is not applicable in this case.

NODIA

Assertion (A).

- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

24. All of the following are regulatory returns submitted to RBI with their corresponding data EXCEPT:
- (A) STAT 5 - Data on transactions related to FCNRB deposits.
 (B) FETERS - Quarterly data on international assets and liabilities.
 (C) STAT 8 - Data on transactions in NRE and NRO deposit accounts.
 (D) BAL Statement - Statement showing balances in NOSTRO and VOSTRO accounts.

May/June 2017

25. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option:
 Assertion (A): The depository bank sets the ratio of U.S. ADRs per home-country share, which can be less than or greater than 1.
 Reason (R): Depository banks wish to price an ADR high enough to show substantial value, yet low enough to make it affordable for individual investors, avoiding penny stocks.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

26. Resident Indians are permitted to maintain various foreign currency accounts. All of the following are permitted foreign currency accounts in India EXCEPT:
- (A) Foreign Currency Non-Resident (Bank) (FCNRB) Accounts for domestic corporations.
 (B) Exchange Earners Foreign Currency (EEFC) Accounts for exporters and residents.
 (C) Resident Foreign Currency (RFC) Accounts

for returning non-resident Indians.

- (D) Diamond Dollar Account (DDA) for registered and active diamond exporters.

May/June 2020

27. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option:
 Assertion (A): An Indian Party making an Overseas Direct Investment (ODI) is required to route all transactions in respect of a particular overseas JV/WOS only through one designated branch of an Authorized Dealer.
 Reason (R): The designated Authorised Dealer is responsible for monitoring the receipt of share certificates and ensuring compliance with the Annual Performance Report submissions.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2015

28. Which of the following most appropriately describes the purpose of EXIM Bank's Product Liability Insurance (PLI) programme?
- (A) To share initial premium costs and protect exporters against product liability risks that might deter market entry.
 (B) To protect banks against the risk of default by overseas buyers on payments due for exported goods and services.
 (C) To insure the physical transport of goods across international borders against piracy, theft, or damage during the transit period.
 (D) To provide life insurance coverage for Indian consultants working on overseas turnkey projects in high-risk geographic locations.

May/June 2013

29. If an Indian exporter requires funding to import specialized technology from a third country to manufacture equipment for an export project, which EXIM Bank service directly addresses this need?
- (A) Lending Programme for Financing Creative Economy to support exporters of art, music, and digital media content.

Oct/Nov 2023

42. What is the definition of Buyer's Credit as offered by the EXIM Bank?
- A credit facility that allows Indian manufacturers to import raw materials on deferred payment terms through specialized commercial banks.
 - A facility enabling overseas buyers to import goods and services from India on deferred payment terms.
 - A short-term financing facility allowing Indian buyers to purchase domestic goods at discounted rates from established public sector units.
 - A programme where foreign project companies receive direct equity investments from the EXIM Bank to execute infrastructure projects in developing nations.

May/June 2016

43. Read the following statements regarding the option of delivery in forward contracts under FEDAI rules:
- Unless the date of delivery is fixed, an option period may be specified at the discretion of a customer, provided it does not extend beyond one month.
 - If the last date of delivery option is a known holiday, the last date for delivery shall be the succeeding working day.
- Which of the above statement(s) is/are correct?
- Only I
 - Only II
 - Both I and II
 - Neither I nor II

Oct/Nov 2009

44. Which of the following defines Direct Investment outside India (ODI)?
- Investments by resident Indians in domestic equities that hold overseas assets and are managed by registered portfolio managers.
 - Remittances made to overseas relatives for the purchase of residential real estate or commercial property in non-prohibited jurisdictions.
 - Long-term capital contribution or subscription to the Memorandum of a foreign entity to signify a lasting interest.
 - Short-term trading of foreign currency securities by Authorized Dealers on behalf of clients in the international capital

markets.

May/June 2023

45. Read the following statements regarding EXIM Bank's operations:
- EXIM Bank extends lines of credit (LOCs) to overseas financial institutions and sovereign governments.
 - EXIM Bank only extends LOCs at the behest and with the support of the Government of India, never on its own.
- Which of the above statement(s) is/are correct?
- Only I
 - Only II
 - Both I and II
 - Neither I nor II

Oct/Nov 2018

46. In which year was the EXIM Bank of India established?
- 1973
 - 1981
 - 1999
 - 2005

May/June 2007

47. Read the following statements regarding the Exchange Earners Foreign Currency (EEFC) Accounts:
- Every recipient of foreign exchange is allowed to retain 100% of the amount in an EEFC account.
 - It is a non-interest bearing current account.
 - Payments towards capital account transactions cannot be debited to EEFC accounts under any circumstances.
- Which of the above statement(s) is/are correct?

- I and II only
- II and III only
- I and III only
- I, II, and III

Oct/Nov 2025

48. How many periodical returns were discontinued by the RBI in terms of the recommendations of the Regulations Review Authority (RRA 2.0)?
- 65
 - 120
 - 250
 - 400

NODIA

outside LRS and may be permitted without any limit.

- (C) It will be subsumed under the employee's personal LRS limit, reducing their available quota for private travel or gifts.
- (D) It requires prior approval from the Ministry of Finance before the remittance can be executed by the Authorized Dealer.

Oct/Nov 2021

72. Arrange the following legislations governing foreign exchange in India in the chronological order of their introduction or enactment:

- I. Introduction of FEMA.
 II. Defence of India Rules (DIR).
 III. FERA 1973.
 IV. FERA 1947.
 (A) II, IV, III, I
 (B) IV, II, III, I
 (C) II, III, IV, I
 (D) III, II, IV, I

May/June 2024

73. According to FEDAI rules, which specific exchange rate must the Authorised Dealer apply when crystallising a foreign currency export liability into a Rupee liability?
- (A) TT selling rate of exchange
 (B) TT buying rate of exchange
 (C) Forward contract buying rate
 (D) Prevailing Bills selling rate

Oct/Nov 2008

74. Match the EXIM Bank Financial Products in List I with their corresponding features in List II:

List I: (Financial Products)

- P. Buyer's Credit
 Q. Lines of Credit
 R. Export Vendor Development Lending Programme (EVDLP)
 S. Product Liability Insurance

List II: (Features)

1. Enabling Indian exporters' market entry by sharing premium costs.
2. Providing credit to overseas buyers to import from India on deferred terms.
3. Enabling exporters to expand business without payment risk from overseas importers.
4. Granting Rupee loans to exporters for strategic vendor development plans.

- (A) P-3, Q-2, R-1, S-4
 (B) P-2, Q-3, R-4, S-1
 (C) P-4, Q-1, R-3, S-2
 (D) P-2, Q-4, R-3, S-1

May/June 2006

75. If an overseas buyer entirely defaults and the export bill is dishonoured before the crystallisation process is initiated, what must the bank recover from the exporter regarding the bill amount?

- (A) Rupee equivalent of the bill and foreign currency charges at the TT selling rate.
 (B) Rupee equivalent of the bill and foreign currency charges at the TT buying rate of the bank.
 (C) Only the appropriate interest and rupee denominated charges as calculated from the date of the default.
 (D) The original foreign currency amount without any conversion into Indian Rupees at the time of recovery.

Oct/Nov 2017

76. Match the Purpose of Remittance requiring prior Government approval in List I with the Approving Ministry/Department in List II:

List I: (Purpose of Remittance)

- P. Cultural Tours
 Q. Remittance of freight vessel chartered by a PSU
 R. Remittance of prize money of sports activity abroad exceeding USD 100,000
 S. Remittance for membership of P&I Club

List II: (Approving Ministry/Department)

1. Ministry of Surface Transport (Chartering Wing)
2. Ministry of Human Resource Development (Department of Youth Affairs and Sports)
3. Ministry of Finance (Insurance Division)
4. Ministry of Human Resource Development (Department of Education and Culture)

- (A) P-2, Q-3, R-4, S-1
 (B) P-1, Q-4, R-3, S-2
 (C) P-4, Q-1, R-2, S-3
 (D) P-3, Q-2, R-1, S-4

May/June 2008

77. When an Indian entity intends to fund an overseas investment via the capitalisation of export proceeds that are already overdue, what specific regulatory requirement applies?

from OECD countries for domestic use in India.

- (C) It enables exporters to support vendor development by granting Rupee loans for creating backward linkages.
- (D) It is an equity participation scheme where EXIM Bank holds shares in the vendor's company to ensure long-term supply chain stability.

May/June 2005

55. Read the following statements regarding the functions of FEDAI:

- I. Issuing guidelines and rules for Forex Business.
- II. Accreditation of Forex Brokers.
- III. Directly fixing the exchange value of the Indian Rupee against the US Dollar.
- IV. Representing member banks on Government/Reserve Bank of India/Other Bodies.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

Oct/Nov 2022

56. Which of the following correctly describes a Level 3 Sponsored ADR?

- (A) It occurs when an issuer floats a public offering of ADRs on a U.S. exchange to raise capital.
- (B) It is found only on the over-the-counter market and has the least SEC requirements compared to other sponsored ADR levels.
- (C) It is quoted on Nasdaq and used solely as an inexpensive way to gauge interest from institutional investors and retail traders.
- (D) It is an unsponsored arrangement set up by multiple US brokers without a formal agreement from the foreign issuing company.

May/June 2018

57. Read the following statements regarding the powers and functions of the Reserve Bank of India under FEMA 1999:

- I. RBI is empowered to control and regulate the foreign exchange reserves and policies related to international trade.
- II. Under Section 11(1), RBI can issue any

direction for the purpose of securing compliance with FEMA.

- III. Under Section 11(3), RBI may impose a penalty up to Rs. 10,000 for contravention of any direction without giving a hearing opportunity.
- IV. RBI compiles national level data on international trade, status of forex flows, and overall international assets.
- V. Penal action can be imposed by RBI for delayed submission of data returns.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2016

58. Which of the following statements regarding the functions and philosophy of EXIM Bank is incorrect?

- (A) It aims to make India's exports internationally competitive by offering finance at competitive rates through various funded and non-funded facilities.
- (B) It restricts its services exclusively to domestic imports and does not finance any overseas investment.
- (C) It develops alternate financing solutions for Indian exporters to mitigate risks associated with international trade and global market volatility.
- (D) It provides data, information, and advice for new export opportunities to Indian exporters to help them expand into emerging global markets.

May/June 2014

59. Read the following statements regarding the activities eligible for EXIM Bank's Export Marketing Fund (EMF) support:

- I. Desk research.
- II. Overseas field market research.
- III. Minor product adaptation.
- IV. Establishing overseas operations.
- V. Payment of corporate income tax in the host country.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) II, III, IV, and V
- (C) I, II, IV, and V
- (D) I, III, IV, and V

NODIA

May/June 2012

49. Read the following statements regarding the Export Marketing Fund (EMF) of EXIM Bank:
- I. EXIM Bank manages the EMF as the nodal agency designated by the Government of India.
 - II. EMF-1 was a component of a World Bank loan to India for the Industrial Export (Engineering products) project.
 - III. The funds are solely restricted to supporting computer software exports.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2014

50. Which of the following accurately describes the shift in objective from the Foreign Exchange Regulation Act (FERA) 1973 to the Foreign Exchange Management Act (FEMA) 1999?
- (A) From promoting external trade through centralized planning to conserving foreign exchange resources for national strategic infrastructure projects.
 - (B) From dealing with violations under Civil laws to dealing with them under Criminal laws to ensure strict compliance with federal statutes.
 - (C) From conserving foreign exchange resources to facilitating external trade and promoting orderly development of foreign exchange markets.
 - (D) From a liberalized regulatory regime focused on market growth to a draconian legislative framework aimed at controlling capital flight.

May/June 2019

51. Read the following statements regarding Global Depository Receipts (GDRs):
- I. A GDR trades as a domestic share but is offered for sale globally through various bank branches.
 - II. They are mainly traded in European countries and particularly in cities like London and Luxemburg.
 - III. GDR transactions in the international market tend to have higher associated costs than other mechanisms.
- Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2006

52. Under FEDAI Rules, what is the conceptual basis for recovering a notional swap cost during the early realization of an export bill?
- (A) It compensates the bank for the administrative expenses of processing documents earlier than anticipated.
 - (B) It functions as a penalty to discourage exporters from receiving funds before the designated transit period ends.
 - (C) It offsets the mandatory stamp duty imposed on the early retirement of export bills.
 - (D) It accounts for the difference in value caused by early delivery under a forward contract mechanism.

May/June 2021

53. Read the following statements regarding FEDAI Rule 2 on Export Transactions:
- I. Interest for the normal transit period and/or usance period shall be recovered upfront simultaneously.
 - II. For crystallisation into Rupee liability, the Authorised Dealer shall apply its TT buying rate of exchange.
 - III. After receipt of advice of realisation of a crystallized bill, the bank applies the TT buying rate to convert proceeds.
 - IV. In case of dishonour of a bill before crystallisation, the bank recovers the Rupee equivalent at the TT selling rate.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
 - (B) I, III, and IV
 - (C) II, III, and IV
 - (D) I, II, and IV

Oct/Nov 2010

54. Which of the following statements regarding the Export Vendor Development Lending Programme (EVDLP) is correct?
- (A) It provides foreign currency loans exclusively to overseas vendors to facilitate the purchase of equipment from Indian manufacturers.
 - (B) It is designed to finance the import of consumer goods and industrial machinery

USD 2,000 or its equivalent, subject to specific rules on acquiring such foreign exchange.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

66. FEDAI rules govern the recovery of exchange difference on the cancellation of a forward contract. The process of recovery includes all of the following features EXCEPT:

- (A) The recovery of the exchange difference can be made either in a lump sum or in installments.
- (B) The repayment period should not extend beyond the maturity date of the forward contract being cancelled.
- (C) The exchange difference in favour of a customer is paid if the contract is cancelled after maturity.
- (D) The repayment installments should be uniformly received over the remaining maturity of the forward contract.

May/June 2017

67. A project export involves an Indian exporter and a Kenyan buyer. Which EXIM Bank facility is most appropriate to offer the Kenyan buyer deferred payment terms while paying the Indian exporter upfront without requiring a Letter of Credit?

- (A) Buyer's Credit
- (B) Overseas Investment Finance
- (C) Export Vendor Development Lending Programme (EVDLP)
- (D) Production Equipment Finance Programme

Oct/Nov 2005

68. When an employee is deputed abroad by an entity for an international conference and the expenses are borne by the entity, what is the most appropriate regulatory treatment for these expenses?

- (A) They are strictly capped at USD 2,50,000 per financial year under the employee's personal Liberalized Remittance Scheme limit.

- (B) They must be approved directly by the Ministry of Human Resource Development before any foreign exchange is released.
- (C) They require the employee to surrender equivalent domestic assets or provide a bank guarantee before departure.
- (D) They are treated as residual current account transactions outside LRS and may be permitted without any limit.

May/June 2020

69. How does EXIM Bank's Product Liability Insurance (PLI) programme assist the exporter in managing high insurance premium costs?

- (A) By granting Rupee loans for implementing strategic vendor development plans within the exporter's domestic supply chain network.
- (B) By fully covering the cost of any litigation arising from product liability claims filed in foreign judicial courts.
- (C) By directly acting as the primary insurance provider in place of established commercial insurance companies for all export risks.
- (D) By sharing initial PLI premium costs to aid the exporter's market entry efforts.

Oct/Nov 2015

70. Under FEDAI Rule 4.6, what is the most appropriate action for a beneficiary bank if it does not receive form A3 within 5 working days of an interbank Vostro transfer by RTGS?

- (A) It must cancel the transfer and return the funds to the remitting bank immediately.
- (B) It must impose a penalty of Rs. 10,000/- per day on the remitting bank.
- (C) It must lodge a claim with the remitting bank within 15 days from the date of transfer of funds.
- (D) It must report the delay directly to the Reserve Bank of India for criminal proceedings.

May/June 2013

71. How is a USD 300,000 expenditure spent by an employer for an employee's business trip to the USA treated under prevailing foreign exchange regulations?

- (A) It will be rejected because it exceeds the LRS limit of USD 250,000 per financial year for individuals and corporates.
- (B) It is a residual current account transaction

NODIA

Oct/Nov 2007

60. Which of the following statements regarding the obligations of an Indian Party that has made a direct investment abroad is incorrect?
- (A) It must receive share certificates within six months from the date of effecting the remittance to the foreign entity.
 - (B) It must repatriate to India all dues receivable from the foreign entity within 60 days of falling due under guidelines.
 - (C) It is required to route all transactions for an overseas JV only through a single branch of an Authorized Dealer.
 - (D) It must submit an Annual Performance Report (APR) in Part II of Form ODI to the Reserve Bank every year on or before December 31.

May/June 2025

61. Read the following statements regarding the provisions for foreign currency accounts and travel:
- I. Returning Indians can open an RFC account to keep foreign currency assets held outside India.
 - II. The RFC(D) account is a non-interest bearing account in the nature of a current account.
 - III. Payment in rupees for purchasing foreign exchange can be done in cash if the rupee equivalent does not exceed Rs. 50,000.
 - IV. When selling foreign exchange for travel, the passport must always be endorsed regardless of the traveller's request.
 - V. For travel to Libya or Iraq, a traveler can receive up to USD 5,000 in foreign currency notes and coins.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V
 - (B) I, II, III, and IV
 - (C) II, III, IV, and V
 - (D) I, III, IV, and V

Oct/Nov 2019

62. EXIM Bank provides support to project export activities across various sectors. The funded and non-funded facilities are extended to all of the following project exports EXCEPT:
- (A) Civil Engineering and Construction Projects involving bridges and dams.
 - (B) Turnkey Projects involving the supply of

equipment and technical services.

- (C) Speculative Real Estate Acquisition Projects.
- (D) Technical and Consultancy Service Contracts for international project management.

May/June 2009

63. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option:
Assertion (A): In the event of early realisation of an export bill, the bank shall refund interest for the unexpired period to the customer.
Reason (R): FEDAI rules stipulate that the bank must pay or recover a notional swap cost as in the case of early delivery under a forward contract.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2011

64. Under the Liberalized Remittance Scheme (LRS), resident individuals can avail of foreign exchange facility up to USD 2,50,000 for various purposes. Any additional remittance requires prior RBI approval EXCEPT for which of the following, if required by the respective country or institute?
- (A) Private visits to any country or territory outside India and Bhutan.
 - (B) Going abroad for employment with a foreign entity or government agency.
 - (C) Travel for attending a specialized training or international conference seminar.
 - (D) Emigration, medical treatment, and studies abroad.

May/June 2010

65. In the following question, a statement of Assertion (A) is followed by a statement of Reason (R). Choose the correct option:
Assertion (A): An individual travelling to the Islamic Republic of Iran can receive the entire amount of drawn foreign exchange in the form of foreign currency notes and coins.
Reason (R): A person resident in India can possess or retain foreign currency notes up to

- (A) It can be done automatically without any notification to the AD.
- (B) It requires prior approval of the Reserve Bank of India.
- (C) It is strictly prohibited under FEMA regulations.
- (D) It requires clearance from the Exporters' caution list authority.

Oct/Nov 2013

- 78.** Match the parts of Form ODI in List I with their respective reporting contents in List II:

List I: (Form ODI Sections)

- P. Part I - Section B
- Q. Part I - Section D
- R. Part II
- S. Part III

List II: (Reporting Contents)

- 1. Declaration by the IP/RI
 - 2. Report on disinvestment
 - 3. Annual Performance Report
 - 4. Capital Structure and other details of Joint Venture / WOS
- (A) P-1, Q-2, R-4, S-3
 - (B) P-3, Q-4, R-2, S-1
 - (C) P-4, Q-1, R-3, S-2
 - (D) P-2, Q-3, R-1, S-4

May/June 2015

- 79.** In an interbank dispute where Bank X lodged a claim within 15 working days from the due date, what is Bank Y's liability regarding the payment of interest for the delay?
- (A) Bank Y is liable to pay interest for a maximum period of 60 days only.
 - (B) Bank Y's claim amount is capped at Rs. 10,000/-.
 - (C) Bank Y is completely exempt from paying interest if the delay was unintentional.
 - (D) Bank Y is liable to pay interest for the full period of delay.

Oct/Nov 2012

- 80.** Which of the following pairs of currencies and their benchmark rates for delayed delivery under FEDAI Rule 8 is correctly matched?
- (A) INR - Prime rate of Citibank NA
 - (B) USD - FBIL - MIBOR overnight rate
 - (C) JPY - Marginal Lending Facility rate of European Central Bank
 - (D) STG - Base rate of Barclays Bank

ANSWERS

NODIA

1. (A) Level 3 - Most basic type of ADR aiming to avoid any public offerings
Level 3 ADRs represent the most advanced stage of sponsorship where a foreign company issues new shares to raise capital from the public in the United States. Unlike basic levels which avoid public offerings, this level requires full compliance with Securities and Exchange Commission reporting standards and listing on a major national stock exchange like Nasdaq.
2. (B) The matter may be referred to FEDAI for a final and binding decision.
Under the guidelines established for interbank settlements, unresolved claims regarding delayed funds are subject to a structured escalation process. If a dispute remains unsettled between the involved banks for a period exceeding sixty days from the date of lodgment, the matter is referred to the Foreign Exchange Dealers' Association of India for a binding decision.
3. (C) Payment related to "Call Back Services" of telephones - Permitted up to USD 50,000.
The Foreign Exchange Management Act outlines specific categories of prohibited remittances to maintain regulatory control and national interests. Payments related to call-back services for telephones are strictly prohibited under current guidelines, rather than being permitted up to a specific limit. This ensures compliance with telecommunications regulations and prevents unauthorized capital outflows through specific service types.
4. (A) A holiday which is known at least 3 working days before the date.
In the context of foreign exchange transactions and contract maturities, the term known holiday has a specific regulatory definition. It refers to any holiday that is announced or publicly acknowledged at least three working days prior to the relevant date. This definition helps dealers and customers manage settlement expectations and avoid unforeseen delays in financial obligations.
5. (A) Only I
Residents in India are granted general permission to utilize funds maintained in their Resident Foreign Currency accounts for purchasing overseas securities. This specific provision allows for flexibility in managing personal foreign exchange holdings. Consequently, such transactions do not require prior approval from the regulator or the submission of the standard direct investment forms typically required for other capital transfers.
6. (D) An arrangement set up by brokers based on market demand where the foreign company has no formal agreement with a depository bank.
An unsponsored American Depositary Receipt is created primarily based on market demand from investors rather than being initiated by the foreign issuer. Brokers or depository banks establish these receipts without entering into a formal legal agreement with the foreign company. This allows for trading in the United States market even if the issuer lacks interest in active promotion.
7. (A) Only I
Foreign exchange dealers apply specific rates when cancelling contracts to ensure consistency and transparency. Sale contracts are cancelled using the authorized dealer's telegraphic transfer buying rate. However, if a contract remains unexecuted after its maturity date, regulations generally prevent the customer from claiming any favourable exchange differences, ensuring that speculative gains from delayed cancellations are not realized.
8. (B) Up to Rs. 2,000.00 per day for which such contravention continues.
The regulatory framework for managing foreign exchange includes strict enforcement mechanisms to ensure compliance with directives. For ongoing violations of specific instructions or rules, the governing body is authorized to impose a financial penalty. This penalty is capped at two thousand rupees for every day during which the contravention continues after the initial discovery of the non-compliance.

9. (B) I and III only

Residents are permitted to hold foreign currency coins without any prescribed ceiling, facilitating ease of travel. Additionally, any unspent foreign exchange brought back to the country can be legally deposited into a Resident Foreign Currency account. Mandatory passport endorsement for every sale of foreign exchange is no longer required in all instances, streamlining the administrative process for travelers.

10. (B) 3 years

Foreign Currency Exchangeable Bonds are specialized financial instruments that allow Indian companies to raise funds by leveraging their holdings in other group companies. To ensure financial stability and long-term capital commitment, regulatory guidelines mandate that these bonds must have a minimum maturity period of three years. This requirement aligns with broader external commercial borrowing policies and debt management strategies.

11. (A) I and II only

Authorized dealers are required to encash foreign currency travelers' cheques at the prevailing buying rates on the transaction date. Small value inward remittances, specifically those up to ten thousand dollars, must be converted into local currency immediately to ensure liquidity. While compensation for delays is mandated, the specific interest rate applied is determined by standardized industry rules rather than high margins.

12. (A) To allow exporters to park foreign currency funds and retire import bills without incurring exchange risk.

The Diamond Dollar Account serves as a specialized foreign currency facility designed to assist exporters in the gemstone industry. By maintaining balances in dollars, these exporters can effectively manage their import payments and export receipts. This mechanism minimizes exposure to exchange rate fluctuations, allowing businesses to settle their trade liabilities directly using the foreign currency earned from global sales.

13. (A) I, II, and III

Indian entities pursuing overseas investments must adhere to sector-specific restrictions, which

generally prohibit activities in the banking and real estate sectors. The automatic route facilitates ease of business by removing the need for prior regulatory approval under specific financial limits. Additionally, eligibility requires that the investing party is not listed on the regulator's caution list for export-related defaults.

14. (B) To price the ADR high enough to show value, yet low enough to be affordable and avoid penny stock status.

Depository banks strategically determine the ratio between home-country shares and depository receipts to optimize trading conditions in the United States market. The goal is to establish a share price that reflects significant corporate value while remaining accessible to individual investors. This prevents the receipt from being classified as a penny stock, which could negatively impact investor perception and liquidity.

15. (B) II, III, and IV

The liberalization of remittance norms allows resident individuals to transfer funds for gifts up to significant annual limits. Regulations strictly prohibit certain outflows, such as subscriptions to proscribed magazines, to maintain national standards. Furthermore, substantial limits are provided for consultancy services related to major infrastructure projects, ensuring that Indian businesses can access global expertise for domestic development.

16. (D) Payment in rupees for the purchase of foreign exchange may be done in cash up to Rs. 50,000.

Regulatory guidelines specify the modes of payment available for purchasing foreign currency for international travel. While larger transactions require electronic transfers or cheques, travelers are permitted to pay in cash for amounts up to fifty thousand rupees. This provides flexibility for smaller travel requirements while ensuring that significant currency transactions are recorded through the formal banking system to prevent money laundering.

17. (A) I, II, and III

Foreign Currency Convertible Bonds are debt instruments issued in a currency other than the issuer's local currency, offering an option for equity conversion. For accounting transparency, companies must periodically mark these

liabilities to market. The market dynamics of these bonds ensure that their price and yield maintain an inverse relationship, which is a standard characteristic of fixed-income securities globally.

18. (B) A matured contract shall be cancelled by the bank on the 3rd working day after the maturity date.

Industry rules define the procedures for handling foreign exchange contracts that are not utilized by their designated date. If a contract remains unfulfilled after reaching maturity, the bank is required to cancel it automatically on the third working day following the maturity date. This standardized timeline ensures that banks can clear outstanding obligations and manage their foreign exchange exposure effectively.

19. (C) I, II, III, and V

Interbank settlements require strict adherence to notified account details to avoid payment delays. Claims for interest due to late fund receipts must be lodged within fifteen working days to ensure full compensation. If a claim is delayed beyond this period, the interest period is capped. Persistent defaults unresolved within sixty days are escalated to the industry association for a final ruling.

20. (A) Remittance for consultancy services for infrastructure projects.

While many specialized remittances like lottery winnings or racing income are strictly prohibited to prevent capital flight and unethical activities, certain business-related payments are encouraged. Remittances for consultancy services required for large-scale infrastructure projects are permitted under existing guidelines. This supports the development of national infrastructure by allowing domestic entities to utilize expert international advice and technical services.

21. (B) I, III, IV, and V

Indian parties investing abroad are obligated to repatriate all receivables within sixty days of the due date to ensure the return of capital. They must also submit an annual performance report detailing the operations of the overseas entity. While certain sectors like banking are restricted, investments can be funded through

various methods, including the capitalization of legitimate export proceeds.

22. (D) The price and the yield on the bond move in the same direction.

Foreign Currency Convertible Bonds represent a hybrid financial instrument that appears as a liability on the balance sheet until converted. Holders possess the flexibility to either switch to equity shares at a set price or receive the principal at maturity. Fundamental bond pricing principles dictate that the market price and the yield of these securities move in opposite directions, not together.

23. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The transition from the 1973 regulation to the 1999 management act marked a significant shift in legislative philosophy. The earlier act was considered draconian because it treated foreign exchange violations as criminal offenses with the possibility of imprisonment. The modern act decriminalized these infractions, treating them as civil matters, thereby creating a more business-friendly environment focused on managing rather than strictly regulating.

24. (B) FETERS - Quarterly data on international assets and liabilities.

Various reporting formats are used by banks to provide data on foreign exchange transactions to the regulator. While returns like STAT five and STAT eight cover specific deposit accounts, and the BAL statement tracks account balances, the reporting frequency is critical. The FETERS return is a bank-wide fortnightly submission rather than a quarterly report, ensuring more frequent monitoring of international transactions.

25. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Depository banks exercise discretion in setting the exchange ratio for American Depositary Receipts to align with market expectations. By adjusting the number of local shares represented by one receipt, the bank can achieve a target trading price. A price that is too low may discourage institutional interest, while a price that is too

high might limit accessibility for individual retail investors.

- 26.** (A) Foreign Currency Non-Resident (Bank) (FCNRB) Accounts for domestic corporations.

Resident entities in India have access to specific foreign currency account types designed to facilitate trade and repatriate funds. These include accounts for exporters to hold earnings and for returning residents to manage overseas assets. However, the Foreign Currency Non-Resident (Bank) account is specifically reserved for Non-Resident Indians and is not available for use by domestic corporate entities for their local operations.

- 27.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

To ensure effective monitoring and regulatory compliance, an Indian entity must conduct all transactions for a specific overseas project through a single designated branch of an authorized dealer. This centralization allows the bank to accurately track capital outflows, monitor the receipt of share certificates, and verify the submission of annual reports, ensuring that the entire investment lifecycle remains transparent.

- 28.** (A) To share initial premium costs and protect exporters against product liability risks that might deter market entry.

The Product Liability Insurance programme is designed to encourage Indian exporters to enter competitive international markets where the risk of litigation is high. By sharing the initial costs of insurance premiums, the institution helps mitigate the financial burden of protecting against claims related to product defects. This support is vital for businesses that might otherwise be deterred by the potential for expensive legal disputes.

- 29.** (C) Import loans for financing third-country imports for projects to be executed in foreign countries.

When Indian companies undertake projects in foreign countries, they often require equipment or technology from specialized global suppliers. To facilitate these complex arrangements, specialized import loans are available to finance the procurement of goods from third countries.

This facility ensures that exporters have the necessary resources to execute international contracts efficiently, even when the required inputs are not sourced from India.

- 30.** (B) To raise overseas debt by leveraging listed group companies without immediately diluting the issuing company's own equity.

Foreign Currency Exchangeable Bonds provide a strategic advantage for corporate groups by allowing a parent company to raise funds using the equity of a listed subsidiary as collateral. This mechanism enables the issuer to access international capital markets without immediate dilution of its own shareholding. It offers investors a way to benefit from the performance of the underlying exchangeable equity shares.

- 31.** (B) USD 3,000

While travelers can draw large amounts of foreign exchange for international trips, there are specific limits on the physical currency they can carry. For most destinations, the maximum amount of foreign exchange that can be obtained in the form of actual notes and coins is three thousand dollars. The remainder of the total amount must be carried via electronic means or travelers' cheques.

- 32.** (D) It shall be deliverable on the second succeeding working day following the contract date.

In the global foreign exchange market, standard settlement periods are established to allow for administrative processing and time zone differences. For a spot contract, the delivery of funds is scheduled to occur on the second working day following the date the contract was initiated. This convention provides a predictable timeline for both buyers and sellers to ensure that the necessary funds are available.

- 33.** (B) It must be surrendered within 180 days from the date of return.

Residents returning from international travel are required to manage their remaining foreign currency in accordance with national regulations. Any unspent foreign exchange in the form of currency notes or travelers' cheques must be surrendered to an authorized dealer. The prescribed timeframe for this surrender is one

68. (D) They are treated as residual current account transactions outside LRS and may be permitted without any limit.

When a company sends an employee abroad for business purposes, such as attending an international conference, the associated costs are considered corporate expenses. These transactions are treated as residual current account payments and are not deducted from the employee's personal annual remittance limit. Consequently, these business-related expenditures can be processed without the strict caps applied to individual personal transfers.

69. (D) By sharing initial PLI premium costs to aid the exporter's market entry efforts.

Entering foreign markets often requires exporters to obtain insurance against potential legal claims related to their products. The high cost of these premiums can be a significant barrier to entry for many businesses. By sharing the initial costs of such insurance, the institution helps exporters manage their financial risk and encourages them to expand their reach into new global markets.

70. (C) It must lodge a claim with the remitting bank within 15 days from the date of transfer of funds. In the event of a documentation delay during an interbank transfer, the receiving bank must follow a specific protocol to protect its interests. If the necessary transfer form is not received within five working days, the bank is required to lodge a formal claim with the remitting institution. This claim must be filed within fifteen days to ensure the recovery of interest.

71. (B) It is a residual current account transaction outside LRS and may be permitted without any limit.

Significant expenditures incurred by an employer for an employee's international business travel are governed by corporate remittance rules rather than individual limits. As long as the trip is for legitimate business purposes, the expenses are classified as residual current account transactions. This classification allows the payment to be made without being restricted by the standard annual limit applicable to individuals.

72. (A) II, IV, III, I

The legal framework for managing foreign exchange has evolved significantly over

several decades. Early regulations began with the wartime defense rules, followed by the first comprehensive regulation act in the late nineteen-forties. A more restrictive act was then introduced in the nineteen-seventies before the current management-focused act was finally enacted at the turn of the millennium to modernize the system.

- (A) TT selling rate of exchange

Crystallization is the process of converting an overdue foreign currency export liability into a local currency liability. According to industry rules, the bank must use its telegraphic transfer selling rate for this conversion. This ensures that the bank is protected against exchange rate fluctuations that may have occurred since the original export bill was negotiated but remained unpaid by the buyer.

74. (B) P-2, Q-3, R-4, S-1

Different financial tools address various needs in international trade. Buyer's credit provides deferred terms to importers, while lines of credit allow exporters to grow without payment risks from individual buyers. Vendor development programmes offer rupee loans to strengthen the supply chain, and insurance support helps manage the costs of protecting against legal liabilities in foreign markets, facilitating successful market entry.

75. (A) Rupee equivalent of the bill and foreign currency charges at the TT selling rate.

When an export bill is dishonored by an overseas buyer, the bank must recover the funds it had previously provided to the exporter. This recovery is conducted by converting the foreign currency amount into local currency using the bank's telegraphic transfer selling rate. Additionally, any associated foreign currency charges are also recovered at this same rate to ensure the bank's full reimbursement.

76. (C) P-4, Q-1, R-2, S-3

Certain types of international remittances require specialized oversight from specific government departments. Cultural tours are managed by the education and culture department, while freight-related payments for state entities involve the transport ministry. Similarly, large prize money for sports requires approval from the

directly to the international purchaser. This allows overseas importers to buy Indian goods and services while deferring their payments over a specified period. This facility is crucial for making large-scale projects and high-value exports more competitive in the global market by offering attractive financing options.

43. (A) Only I

Customers utilizing forward contracts can choose an option period for delivery that does not exceed one month, providing flexibility in their trade settlements. However, if the final day of this chosen period falls on a known holiday, regulations specify that the contract must be settled on the preceding working day rather than the succeeding one to ensure timely fulfillment.

44. (C) Long-term capital contribution or subscription to the Memorandum of a foreign entity to signify a lasting interest.

Overseas Direct Investment is defined by the intent to establish a long-term presence and influence in a foreign entity. This is typically achieved through capital contributions or the subscription to the memorandum of association of a foreign company. Unlike short-term portfolio investments, this indicates a lasting interest and a strategic commitment to the operations of the international business unit.

45. (A) Only I

Lines of credit are a primary tool used to facilitate international trade by providing credit to foreign governments and financial institutions. These facilities allow overseas buyers to procure Indian goods and services with ease. While often supported by the national government, the institution also has the capability to extend these lines of credit based on its own commercial judgment.

46. (B) 1981

The specialized financial institution dedicated to promoting the country's international trade was established by an act of parliament in 1981. It began its operations shortly thereafter to provide financial assistance to exporters and importers. Since its inception, it has served as a principal institution for coordinating the working of entities engaged in financing export and import transactions.

47. (A) I and II only

Exporters and other foreign exchange earners can retain their entire earnings in a specialized account to manage future requirements. This account is designed as a non-interest bearing current account to facilitate trade-related payments. Contrary to strict prohibitions, these funds can sometimes be utilized for specific capital account transactions, such as making approved overseas direct investments under the automatic route.

48. (C) 250

As part of a broader initiative to simplify the regulatory environment and reduce the compliance burden on financial institutions, the regulator reviewed its reporting requirements. Based on the recommendations of a specialized review authority, approximately two hundred and fifty periodical returns were discontinued. This move aimed to streamline data collection and allow banks to focus on more critical risk management activities.

49. (A) I and II only

The Export Marketing Fund was created to support the expansion of industrial exports, particularly engineering products, using resources from international development loans. The institution serves as the nodal agency for managing these funds. While it provides critical support for various sectors to improve their global market reach, the fund's scope is broad and not limited to software.

50. (C) From conserving foreign exchange resources to facilitating external trade and promoting orderly development of foreign exchange markets.

The legislative change from the older regulation to the modern management act reflected a fundamental shift in economic policy. The earlier focus was on the strict conservation of scarce foreign exchange resources through control. The newer framework prioritizes the facilitation of external trade and the promotion of an orderly and efficient foreign exchange market, supporting the nation's integration into the global economy.

51. (A) I and II only

Global Depository Receipts allow companies to offer their shares to investors across multiple

IV. Domestic micro-finance lending and agricultural subsidies.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, III, and IV

Oct/Nov 2006

13. How do the reserve requirements for banks operating in an IFSC differ from those operating in the domestic Indian economy?

- (A) IFSC banks must maintain double the standard Cash Reserve Ratio to mitigate cross-border risks and currency volatility.
- (B) IFSC banks operate like foreign branches and are exempt from domestic reserve requirements (CRR/SLR).
- (C) IFSC banks must maintain Statutory Liquidity Ratio strictly in foreign government securities issued by AAA-rated nations.
- (D) IFSC banks are required to maintain reserves exclusively with the home country regulator of the primary foreign investors.

May/June 2021

14. Evaluate the following operational aspects of IBUs:

- I. Cash transactions are heavily monitored but permitted up to specified limits.
- II. Deposits can be maintained in current accounts and term deposits.
- III. Indian KYC-AML and delinquency norms are strictly applicable.
- IV. Deposits with IBUs are not insured.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, III, and IV

Oct/Nov 2010

15. Which of the following accurately describes a business opportunity at GIFT City?

- (A) Exclusively serving the domestic agricultural sector to boost rural credit expansion.
- (B) Replacing the Reserve Bank of India as the sole currency issuing authority for the state of Gujarat.
- (C) Restricting inbound and outbound gateway services to ensure complete capital

protection for domestic retail investors.

- (D) Connecting a 30 million strong Indian diaspora with a combined worth of USD 3 trillion to India through the IFSC.

May/June 2018

16. Regarding exposure ceilings and regulations for IBUs, consider the following:

- I. Exposure ceiling shall be 5% of the parent Bank Tier I Capital for a single borrower.
- II. Exposure ceiling shall be 10% of the parent Bank Tier I Capital for a borrower group.
- III. The IBUs are regulated and supervised by the RBI/IFSCA.
- IV. IBUs operate and maintain their balance sheet only in Indian Rupees.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

Oct/Nov 2011

17. Which of the following statements correctly identifies a relaxation provided to Foreign Portfolio Investors (FPIs) at GIFT City?

- (A) FPIs must pay a 30% short term capital gains tax on derivatives trades in the IFSC.
- (B) FPIs are allowed to trade in commodity derivatives on IFSC exchanges.
- (C) FPIs can operate on exchanges for a maximum of 8 hours a day to prevent market volatility.
- (D) FPIs must submit supplementary documentation every quarter to trade on the IFSC exchanges.

May/June 2014

18. Consider the following statements regarding the permissible activities of IBUs:

- I. All transactions shall be in a currency other than INR.
- II. They can open foreign currency current accounts for corporate borrowers subject to FEMA.
- III. No cheque facility will be available for holders of current accounts.
- IV. They are permitted to undertake derivative products without any prior approval.
- V. They can act as underwriters for INR denominated Overseas bonds issued by Indian entities.

- 60.** (D) It must submit an Annual Performance Report (APR) in Part II of Form ODI to the Reserve Bank every year on or before December 31.

Indian parties are required to follow strict timelines for documenting their overseas investments, including receiving certificates within six months. They must also repatriate dues promptly and use a single bank branch for all transactions related to a specific venture. While annual reporting is mandatory, the specific details or deadlines regarding the performance report must align precisely with the latest regulatory updates.

- 61.** (A) I, II, III, and V

Returning residents can maintain their foreign assets in specialized accounts, and small value cash payments for currency are permitted. Specialized limits exist for certain countries like Libya and Iraq, allowing travelers to carry more physical cash. Mandatory passport endorsement for all sales of foreign exchange is no longer a strict requirement for every traveler, providing a more streamlined administrative experience.

- 62.** (C) Speculative Real Estate Acquisition Projects. Support for project exports is focused on activities that enhance the country's reputation for technical and engineering excellence. This includes large-scale construction, turnkey projects, and high-value consultancy services. However, speculative ventures such as the acquisition of real estate for investment purposes do not fall under the purview of these specialized trade finance facilities and are generally excluded from such support.

- 63.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

If an exporter receives payment before the expected date, the bank is obligated to refund the interest collected for the unexpired portion of the transit or usance period. While the bank also calculates a swap cost to manage the timing difference in currency delivery, this calculation is a separate procedural requirement and does not serve as the direct reason for the refund.

- 64.** (D) Emigration, medical treatment, and studies abroad.

The liberalized scheme provides a significant annual limit for most personal and travel-related remittances. While transactions exceeding this limit usually require prior approval, certain essential categories are exempted if higher amounts are necessitated by the host country or institution. These critical exceptions include funds required for emigration, specialized medical treatment abroad, and the payment of international educational expenses.

- 65.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Travelers to certain countries, including Iran, are permitted to carry their entire drawn foreign exchange in cash due to local banking limitations. Separately, there is a general rule allowing residents to hold up to two thousand dollars in foreign notes for future use. Although both statements are factually correct, the general possession rule does not explain the specific exception for Iran.

- 66.** (C) The exchange difference in favour of a customer is paid if the contract is cancelled after maturity.

Rules for cancelling forward contracts allow for the recovery of exchange differences through various payment methods, provided the timeline does not exceed the contract's maturity. However, a key restriction prevents the payment of any favorable exchange difference to a customer if the cancellation occurs after the contract has already matured. This ensures that customers do not profit from delaying the cancellation.

- 67.** (A) Buyer's Credit

For an Indian exporter to successfully compete for an international project, offering flexible payment terms to the buyer is essential. The buyer's credit facility allows the overseas purchaser to pay for the project over time while ensuring the Indian exporter receives their funds upfront. This arrangement removes the immediate payment burden from the buyer and eliminates credit risk for the exporter.

hundred and eighty days from the date of the traveler's return to the country.

34. (B) III, I, II, IV

The process for managing interbank transfer delays begins with the remitting bank including a specific remark in the electronic message. If the required documentation is not received within five working days, the beneficiary bank must then lodge a formal claim within fifteen days. This structured approach concludes with the remitting bank paying the prescribed daily penalty for the duration of the delay.

35. (D) Normal transit period is not applicable in this case.

Normal transit periods are typically applied to account for the time it takes for documents to reach an overseas destination. However, when a usance bill has a fixed due date that is calculated specifically from the date of shipment, the transit time is already inherently accounted for in the maturity calculation. Therefore, additional transit period allowances are not applicable under industry settlement rules.

36. (A) P-3, Q-1, R-4, S-2

Regulatory reporting involves various specialized statements to track different financial activities. The FETERS return provides fortnightly data on overall operations, while STAT five focuses on specific non-resident deposits. Similarly, STAT eight tracks other deposit accounts, and the BAL statement is used to report balances held in international and domestic correspondent accounts, ensuring comprehensive oversight of the foreign exchange system.

37. (B) Approach the AD with an application in Form ODI and prescribed enclosures.

The automatic route for overseas investment simplifies the process for Indian entities by bypassing the need for direct regulatory approval for each transaction. To utilize this facility, the entity must submit a completed application using the standard investment form along with necessary supporting documents to their authorized dealer. The bank then verifies compliance with existing limits before facilitating the remittance.

38. (D) P-4, Q-1, R-3, S-2

Different transit periods are assigned based on the nature of the export bill and the reimbursement method. Bills in foreign currencies generally have a twenty-day period, while specialized humanitarian exports can have much longer durations. Conversely, electronic reimbursements are processed much faster, with a five-day limit, and rupee-denominated bills under letters of credit are typically assigned a twenty-five-day transit period.

39. (C) An Annual Performance Report (APR) in Part II of Form ODI.

Ongoing monitoring of overseas investments is maintained through periodic reporting requirements. Every Indian entity with a joint venture or wholly owned subsidiary abroad must provide a detailed update on the performance and financial status of that entity. This update is submitted annually using a specific section of the direct investment form by the end of the calendar year.

40. (B) DDA Accounts - Diamond exporters with two years in export trade

Specialized foreign currency accounts are tailored to the needs of specific groups within the economy. The Diamond Dollar Account is correctly designated for exporters in the gemstone industry who have a proven track record of at least two years. Other accounts are available for returning residents or general exporters, but each has specific eligibility criteria that must be met to operate.

41. (A) 2% over the Prime rate of Citibank N A

When interbank settlements involving United States dollars are delayed, a standardized interest rate is used to calculate compensation. This rate is set at two percent above the prime rate of a major international bank, specifically Citibank. This benchmark ensures that the buyer is fairly compensated for the loss of liquidity while maintaining a transparent and consistent rule across the industry.

42. (B) A facility enabling overseas buyers to import goods and services from India on deferred payment terms.

Buyer's credit is a financing mechanism that supports national exports by providing credit

sports ministry, and memberships in specialized maritime insurance clubs are overseen by the finance ministry's insurance division.

- 77.** (B) It requires prior approval of the Reserve Bank of India.

Indian entities may wish to use their export earnings to fund investments in overseas subsidiaries. While this is generally permitted, if the export proceeds in question are already overdue, the transaction no longer falls under the automatic route. In such cases, the entity must obtain specific prior approval from the central bank before it can proceed with the capitalization of those funds.

- 78.** (C) P-4, Q-1, R-3, S-2

The documentation for overseas investments is divided into several sections for systematic reporting. These sections cover the capital structure of the foreign entity, formal declarations by the investing party, and the ongoing annual performance reports. Additionally, specialized sections are used to report any disinvestment or liquidation of the overseas venture, ensuring that the regulator has a complete record of the investment life.

- 79.** (D) Bank Y is liable to pay interest for the full period of delay.

In interbank disputes regarding delayed payments, the timing of the claim is critical for determining compensation. If the bank awaiting funds lodges its claim within the prescribed fifteen-day window, the defaulting bank is held fully responsible for the delay. Under these circumstances, the liable bank must pay interest for the entire duration that the funds remained outstanding until the settlement.

- 80.** (D) STG - Base rate of Barclays Bank

For interbank settlement delays, specific benchmark rates are used for different global currencies to calculate interest. While the United States dollar uses a prime rate from a major American bank, the British pound sterling is benchmarked against the base rate of Barclays Bank. These standardized benchmarks provide a clear and fair basis for settling interest claims across various international currency transactions.

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CHAPTER 09

International Financial Service Centre, GIFT City

Oct/Nov 2014

1. To manage international inward remittances efficiently, an IBU decides to maintain a Special Non-Resident Rupee (SNRR) account with a domestic Authorized Dealer (AD). A domestic corporate client attempts to deposit Indian Rupees directly into this SNRR account to settle an invoice. How should the IBU handle this deposit?
 - (A) Accept the deposit as it facilitates ease of doing business for domestic clients and reduces transaction friction for the IBU.
 - (B) Reject the deposit, as SNRR accounts must be funded strictly by foreign currency remittances through international channels.
 - (C) Accept the deposit but freeze the funds for 15 days for compliance checking by the integrated financial services authority.
 - (D) Redirect the domestic client to deposit the funds into the IBU's special administrative rupee account to cover localized statutory costs.

May/June 2023

2. Which of the following pairs regarding GIFT City's business operations is INCORRECTLY matched?
 - (A) IFSCA Headquarters : Gandhinagar, Gujarat
 - (B) Retail Banking opportunity : Wealth management and certificate of deposits
 - (C) Section 98 of Finance Act 2004 : Levies double taxation on non-residents in IFSC
 - (D) Treasury management opportunity : Asset Liability Management (ALM)

Oct/Nov 2018

3. What does the term 'Non Deliverable Forwards' (NDF) represent in the context of treasury management?
 - (A) A cash-settled, short-term forward contract where the notional amount is never exchanged.

- (B) A physical delivery-based forward contract involving the exchange of two domestic currencies under fixed exchange rates.
 - (C) A derivative instrument used exclusively for interest rate swapping among central banks to stabilize national debt.
 - (D) An options contract providing the right to buy government securities at a predetermined future date and specified price.

May/June 2005

4. Consider the following statements regarding IBUs and priority sector lending:
 - I. Loans and advances issued by IBUs are reckoned as part of the Net Bank Credit of the Parent Bank for computing priority sector lending obligations.
 - II. The Reserve Bank of India provides a special liquidity support window specifically designed for IBUs.

Which of the above statements is/are correct?

- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2022

5. What is a 'Wholly Owned Subsidiary' (WOS) in the context of international business entities?
 - (A) An entity where equity contribution is shared equally between an Indian party and a foreign investor.
 - (B) A foreign branch of a domestic bank focused solely on processing outward remittances.
 - (C) A specialized financial vehicle designed to issue American Depositary Receipts.
 - (D) An entity where the entire equity contribution in a foreign entity is invested by the Indian Party.

May/June 2011

6. Consider the following statements about accounts maintained by IBUs:
- I. IBUs are allowed to open Savings Bank accounts for non-resident retail customers to encourage foreign inward remittances.
 - II. IBUs are required to maintain separate Nostro accounts with correspondent banks which must be distinct from Nostro accounts of other branches of the same bank.
- Which of the above statements is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2019

7. As per the operational status reports from the early phase of GIFT City, how many companies, including banks, were part of the hub?
- (A) 150 companies, including 5 PSBs and several specialized cooperative credit institutions.
 - (B) 225 companies, including 3 PSBs, 9 Private Sector Banks, and 3 MNC Banks.
 - (C) 500 companies, including 10 Private Sector Banks and various insurance brokerage firms.
 - (D) 100 companies, exclusively comprising multinational corporations and global investment trusts.

May/June 2016

8. Regarding the guidelines for Indian Banks setting up IBUs, evaluate the following statements:
- I. Only Public Sector Banks are eligible to set up IBUs.
 - II. Each eligible bank is permitted to set up only one IBU in each IFSC.
 - III. Deployment of funds with persons resident in India is subject to the provisions of FEMA 1999.
- Which of the above statement(s) is/are correct?
- (A) I and II
 - (B) II and III
 - (C) I and III
 - (D) I, II, and III

Oct/Nov 2009

9. What is the minimum capital requirement that a parent bank must provide to its IFSC Banking Unit (IBU)?
- (A) USD 10 Million or equivalent in any foreign

currency

- (B) USD 20 Million or equivalent in any foreign currency
- (C) USD 50 Million or equivalent in Indian Rupees
- (D) USD 100 Million or equivalent in any foreign currency

May/June 2007

10. Analyze the following statements on the regulatory framework for IBUs:
- I. The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio may be maintained at the parent level with IFSCA permission.
 - II. IBUs must maintain a retail deposit reserve ratio on a daily basis at 3% of deposits raised from individuals.
 - III. Leverage ratio for IBUs must be calculated daily and reported directly to the World Bank.
- Which of the above statement(s) is/are correct?
- (A) I and II
 - (B) II and III
 - (C) I and III
 - (D) I, II, and III

Oct/Nov 2016

11. What is the primary rationale for prohibiting IFSC Banking Units (IBUs) from opening Savings Bank accounts?
- (A) IBUs cannot engage in cash transactions and are not designed for traditional domestic retail banking needs.
 - (B) IBUs lack the technological infrastructure required to calculate daily interest on savings accounts for individual depositors.
 - (C) The RBI mandates that savings accounts can only be operated by non-resident corporate entities with high net worth.
 - (D) IBUs are legally prohibited from paying interest to depositors under the specific provisions of the SEZ Act 2005.

May/June 2025

12. An IFSC emphasizes various cross-border financial services. Consider the following:
- I. Fund raising services for Individuals, Corporates and Governments.
 - II. Asset Management and Global Portfolio Diversification.
 - III. Global tax management and cross border tax liability optimization.

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international markets simultaneously. These instruments are frequently traded on major European exchanges, providing significant visibility to global investors. By using these receipts, a company can tap into international capital pools efficiently, often finding it more cost-effective than attempting multiple individual listings in various domestic markets worldwide.

52. (D) It accounts for the difference in value caused by early delivery under a forward contract mechanism.

When an export bill is realized earlier than its scheduled maturity, it affects the bank's underlying currency positions. To address this, a notional swap cost is calculated, mirroring the process used for the early delivery of funds under a forward contract. This ensures that the financial impact of the timing difference is properly accounted for between the customer and the bank.

53. (B) I, III, and IV

Interest for the transit and usance periods is typically recovered at the beginning of an export transaction. If a bill is dishonored, the bank must recover the equivalent amount using its selling rate. However, once a bill is crystallized, subsequent conversions of realized proceeds are done at the buying rate. The initial conversion for crystallization itself uses the selling rate.

54. (C) It enables exporters to support vendor development by granting Rupee loans for creating backward linkages.

The Export Vendor Development Lending Programme is an initiative that helps exporters strengthen their supply chains. By providing rupee-denominated loans, the programme enables exporters to fund the development of their domestic vendors. This support for backward linkages ensures a more reliable and higher-quality supply of components and materials, ultimately enhancing the competitiveness of the final exported products.

55. (B) I, II, and IV

This industry body plays a vital role in regulating and supporting the foreign exchange market. Its primary functions include establishing rules for forex business, accrediting brokers, and representing the interests of member banks

before the government and regulator. However, it does not have the authority to fix exchange rates, which are determined by market forces and central bank policy.

56. (A) It occurs when an issuer floats a public offering of ADRs on a U.S. exchange to raise capital.

A Level 3 sponsored ADR represents the highest level of participation for a foreign company in the United States capital markets. It involves a formal public offering of shares, allowing the company to raise new capital directly from American investors. This requires the issuer to meet stringent reporting requirements and maintain a listing on a major national stock exchange.

57. (B) I, II, IV, and V

The central bank is vested with broad powers to regulate foreign exchange flows and ensure compliance with national trade policies. It can issue binding directions and impose penalties for delayed data submissions. While it has the authority to penalize contraventions, it must follow due process by providing the concerned party an opportunity to be heard before any fine is levied.

58. (B) It restricts its services exclusively to domestic imports and does not finance any overseas investment.

The institution operates with a comprehensive mandate to support both the inflow and outflow of trade and capital. It provides a wide range of services, including financing for overseas investments by Indian companies and offering competitive rates for exports. Claiming that it restricts its activities solely to domestic imports or avoids international investment support contradicts its core mission and functional scope.

59. (A) I, II, III, and IV

The Export Marketing Fund provides financial support for a variety of activities aimed at increasing international market share. This includes market research, minor product adaptations to meet foreign standards, and the costs associated with establishing operations in new territories. However, routine business expenses such as the payment of corporate income taxes in host countries are not covered by this specialized fund.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2007

19. Regarding the permissible activities at IBUs, which of the following statements is incorrect?
- (A) IBUs are permitted to participate in the Indian domestic call, notice, and term money markets.
 - (B) All transactions at IBUs shall be conducted in a currency other than INR.
 - (C) IBUs are allowed to act as underwriters for INR denominated Overseas bonds issued by Indian entities in Overseas markets.
 - (D) IBUs are permitted to undertake factoring and forfaiting of export receivables.

May/June 2022

20. Evaluate the following statements regarding FPI relaxations and operations at GIFT City:
- I. SEBI allows registered FPIs to trade on exchanges operating in GIFT City.
 - II. FPIs are completely barred from trading in commodity derivatives on IFSC exchanges.
 - III. Companies in the IFSC do not pay securities transaction tax.
 - IV. Exchanges operate 22 hours a day.
 - V. Retail investors are allowed to trade to build liquidity in the market.
- Which of the above statement(s) is/are correct?
- (A) I, III, IV, and V
 - (B) I, II, III, and V
 - (C) II, III, IV, and V
 - (D) I, II, IV, and V

Oct/Nov 2023

21. Identify the incorrect statement regarding the handling of accounts and funds by IBUs:
- (A) IBUs are allowed to open foreign currency escrow accounts of Indian resident entities for temporary subscriptions to GDR/ADR issues.
 - (B) All transactions in IBUs must be done through bank transfers.
 - (C) IBUs may maintain Special Non-Resident Rupee (SNRR) accounts with domestic ADs.
 - (D) Current accounts in IBUs are provided with standard cheque book facilities to ease corporate transactions.

May/June 2019

22. The following questions consist of two statements—an Assertion (A) and a Reason (R). Answer the questions by selecting the appropriate option.
- Assertion (A): A Special Economic Zone (SEZ) serves as an effective testing ground for financial sector reforms before they are rolled out nationally.
- Reason (R): India's financial sector has many restrictions, such as partial capital account convertibility and high SLR requirements, making a controlled zone necessary for experimental rollouts.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2011

23. Prior to the establishment of the International Financial Services Centres Authority (IFSCA), the businesses in IFSC were regulated by several authorities. Which of the following was NOT one of those existing regulators?
- (A) Securities and Exchange Board of India (SEBI)
 - (B) Competition Commission of India (CCI)
 - (C) Pension Fund Regulatory and Development Authority (PFRDA)
 - (D) Insurance Regulatory and Development Authority of India (IRDAI)

May/June 2010

24. The following questions consist of two statements—an Assertion (A) and a Reason (R). Answer the questions by selecting the appropriate option.
- Assertion (A): IBUs are allowed to maintain balance sheets in Indian Rupees to facilitate seamless domestic integration.
- Reason (R): IBUs are permitted to have a special rupee account solely for the purpose of defraying their administrative and statutory expenses.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true,

Oct/Nov 2022

47. Consider the following statements regarding the scope and objectives of an IFSC in India:
- Banks in IFSCs operate as foreign branches of the parent bank.
 - They are permitted to lend in foreign currencies to resident corporates strictly for trade transactions.
 - They are subject to stringent domestic reserve requirements to prevent capital flight.
- Which of the above statement(s) is/are correct?
- I and II
 - II and III
 - I and III
 - I, II, and III

May/June 2009

48. When was the International Financial Services Centres Authority (IFSCA) established?
- 5th December 2019
 - 27th April 2020
 - 1st January 2021
 - 31st October 2018

Oct/Nov 2014

49. Identify the correct statements regarding the role and structure of IFSCA:
- IFSCA was established on April 27th 2020 under the IFSCA Act 2019.
 - It functions as a unified authority for the development and regulation of financial products in the IFSC.
 - Prior to its establishment, businesses in IFSC were completely unregulated to promote free trade.
- Which of the above statement(s) is/are correct?
- I and II
 - II and III
 - I and III
 - I, II, and III

May/June 2019

50. Why is a Special Economic Zone (SEZ) considered an ideal testing ground for financial sector reforms in India?
- It eliminates the need for any regulatory oversight by the Reserve Bank of India for all cross-border transactions.
 - It provides a mechanism to bypass international anti-money laundering guidelines to attract high-risk offshore

capital.

- It permits testing reforms before national rollout due to existing restrictions like capital convertibility and high SLR.
- It restricts foreign banks from competing with domestic public sector banks within the specialized economic zone.

Oct/Nov 2006

51. Regarding the permissible activities of IBUs, consider these statements:
- IBUs are permitted to undertake factoring and forfaiting of export receivables.
 - All AML/CFT instructions issued by the regulator must be followed by the IBUs.
 - IBUs can issue cheque books to their current account holders for domestic payments.
- Which of the above statement(s) is/are correct?
- I and II
 - II and III
 - I and III
 - I, II, and III

May/June 2025

52. What is the purpose of an IBU maintaining a 'Special Rupee Account' when it is primarily required to operate in foreign currency?
- To facilitate retail lending to domestic customers in Indian Rupees.
 - To participate in the Indian domestic call and notice money markets.
 - To accept deposits from Indian resident individuals in domestic currency.
 - To defray their administrative and statutory expenses in Indian Rupees.

Oct/Nov 2007

53. GIFT City presents several opportunities. Evaluate the following:
- Access to international markets.
 - Potential to be a leading destination for Global in-house Centers with globally competitive cost structure.
 - Emerging as a leading hub for fund administration.
 - Mandating foreign corporations to shift their primary headquarters to India.
- Which of the above statement(s) is/are correct?
- I, II, and III
 - I, II, and IV
 - II, III, and IV
 - I, III, and IV

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purposes. He wishes to open a Savings Bank (SB) account to park his idle foreign currency funds. Additionally, he requests a cheque book to manage ad-hoc payments.

According to the operational aspects and permissible activities of IBUs, how will the bank process his request?

- (A) The bank will open the SB account and issue the cheque book as HNIs are exempt from standard IBU restrictions under new norms.
- (B) The bank will open the SB account but refuse the cheque book facility, mandating all transactions via physical cash exchanges.
- (C) Decline both requests, as SB accounts are not allowed and no cheque facility is available in IBUs.
- (D) The bank will allow the cheque book facility but insist on opening a fixed term deposit instead of a traditional savings account.

Oct/Nov 2021

31. How is an IBU most appropriately expected to manage its day-to-day administrative and statutory expenses locally in India?

- (A) By converting foreign currency into Indian Rupees directly in the open domestic forex market.
- (B) By utilizing petty cash funds generated from retail savings accounts and interest earned on domestic term deposits.
- (C) By borrowing Indian Rupees from the Reserve Bank of India's liquidity adjustment facility during overnight window operations.
- (D) By maintaining a special rupee account through an Authorized Dealer, subject to foreign exchange regulations.

May/June 2024

32. An Indian resident entity is launching a Global Depository Receipt (GDR) issue to raise capital in international markets. To manage the temporary subscriptions before the official issuance of receipts, the entity approaches an IBU to open an account.

Which type of account is the IBU permitted to open for this specific purpose?

- (A) A domestic Indian Rupee Current Account with unlimited overdraft facilities to cover potential subscription shortfalls.
- (B) A Special Non-Resident Rupee (SNRR) Savings Account intended for individual

foreign investors contributing to the capital raise.

- (C) A standard resident offshore term deposit account to park funds until the regulatory clearance for the issue is obtained.
- (D) A foreign currency Escrow account designated for temporary subscriptions to GDR issues.

Oct/Nov 2008

33. Arrange the events related to the evolution and operation of GIFT City and IFSCA in their correct chronological sequence:

- I. Establishment of the Special Economic Zones Act providing testing ground for reforms.
- II. GIFT City started functioning at Gandhinagar.
- III. Establishment of the IFSCA to act as a unified regulator.

- (A) I, II, III
- (B) I, III, II
- (C) II, I, III
- (D) III, II, I

May/June 2006

34. An IBU operating in GIFT City incurs monthly expenses for office rent, electricity, and employee salaries which must be paid locally in Indian Rupees. Since the IBU is mandated to operate its balance sheet only in foreign currency, how should it legally facilitate the payment of these local administrative expenses?

- (A) By conducting unregulated cash exchanges with local domestic banks at prevailing market rates through informal channels.
- (B) By forcing local vendors to accept payments in US Dollars or other G7 currencies regardless of domestic legal tender laws.
- (C) By maintaining a special rupee account through an Authorized Dealer, subject to foreign exchange regulations.
- (D) By issuing offshore bonds explicitly meant for covering administrative overheads and local operational costs in the SEZ.

Oct/Nov 2017

35. Match the key business opportunity segments at GIFT City in List-I with their corresponding activities in List-II.

List I: (Segments)

P. Wholesale banking

(C) I, III, IV, and V

(D) I, II, IV, and V

May/June 2005

60. Which of the following statements regarding the regulatory framework of IFSCA is incorrect?

(A) Indian and Foreign Banks intending to set up an IBU must obtain a license from IFSCA.

(B) Parent banks must obtain a No Objection letter from their home country regulator to set up an IBU in IFSC.

(C) Liquidity Coverage Ratio and Net Stable Funding Ratio must be maintained at the IBU level with no exceptions.

(D) The parent bank must maintain regulatory capital subject to a minimum of USD 20 Million to ensure solvency.

Oct/Nov 2011

61. Assess the following definitions related to international financial operations:

I. External Commercial Borrowings (ECB) refers to Indian entities borrowing from abroad for capital expansion.

II. ALM involves managing assets and liabilities to mitigate involved risks.

III. NDF is a cash-settled contract where the notional amount is frequently exchanged.

IV. CRR requires banks to maintain a percentage of NDTL in the form of Cash with the RBI.

V. Escrow accounts are opened for specific purposes involving a tripartite agreement.

Which of the above statement(s) is/are correct?

(A) I, II, IV, and V

(B) I, II, III, and IV

(C) II, III, IV, and V

(D) I, III, IV, and V

May/June 2010

62. The key business opportunities at GIFT City in the wholesale banking segment include all of the following, EXCEPT:

(A) External Commercial Borrowings (ECB) and Trade Finance

(B) Factoring and Forfaiting services for cross-border export receivables.

(C) Retail deposit mobilization via savings accounts.

(D) Guarantee and Indemnity business for international trade transactions.

Oct/Nov 2021

63. The following questions consist of two statements—an Assertion (A) and a Reason (R). Answer the questions by selecting the appropriate option.

Assertion (A): Current accounts held in IFSC Banking Units (IBUs) are not provided with any cheque facilities.

Reason (R): All transactions in an IBU are strictly required to be done through bank transfers to maintain stringent tracking of cross-border financial flows.

(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

(C) Assertion (A) is true, but Reason (R) is false.

(D) Assertion (A) is false, but Reason (R) is true.

May/June 2024

64. IBUs are permitted to undertake various transactions to facilitate international financial services. Which of the following is NOT a permissible activity for an IBU?

(A) Dealing with Wholly Owned Subsidiaries (WOS) of Indian companies registered abroad.

(B) Opening foreign currency current accounts of units operating in IFSCs.

(C) Undertaking transactions with non-resident entities for raising resources.

(D) Providing liquidity support to other domestic branches of the parent bank using RBI funds.

Oct/Nov 2008

65. The following questions consist of two statements—an Assertion (A) and a Reason (R). Answer the questions by selecting the appropriate option.

Assertion (A): The International Financial Services Centres Authority (IFSCA) was established as a unified regulator with a holistic vision for the IFSC.

Reason (R): Regulating an IFSC requires a high degree of inter-regulatory coordination within the financial sector to promote ease of doing business.

(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of

undertake?

- (A) The IBU must obtain prior approval from the regulator (RBI/IFSCA) for offering derivative products.
- (B) The IBU must secure a minimum of USD 100 Million in new capital from the global equity markets to cover potential market risks.
- (C) The IBU must receive a legislative amendment passed by the Parliament of India specifically authorizing these complex instruments.
- (D) The IBU must issue a public notice in local newspapers and international financial journals 30 days prior to the product launch.

Oct/Nov 2020

41. Which of the following pairs of 'Entity/Term' and 'Associated Feature' is INCORRECTLY matched?
- (A) FPIs at GIFT City : Pay 30% short term capital gains tax on derivatives
 - (B) Special Economic Zone (SEZ) : Testing ground for financial sector reforms
 - (C) IBU Balance Sheet : Operated and maintained only in foreign currency
 - (D) Current Accounts at IBU : Subject to FEMA regulations for corporate borrowers

May/June 2023

42. Which of the following best defines an International Financial Service Centre (IFSC)?
- (A) A domestic financial hub strictly regulated by the central bank to promote inland agricultural loans and rural credit expansion.
 - (B) A center for customers outside the domestic economy, handling cross-border financial flows.
 - (C) A dedicated zone exclusively for the resolution of non-performing assets of public sector banks through specialized tribunals.
 - (D) A sovereign wealth fund established by the government to manage foreign exchange reserves and national pension liabilities.

Oct/Nov 2025

43. Consider the following statements regarding the capital requirements of an IBU:
- I. The parent bank is required to provide a minimum capital of USD 20 Million or equivalent in any foreign currency to its

IBU.

- II. This minimum capital must be maintained at all times.

Which of the above statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2016

44. Which of the following defines an 'Escrow account'?
- (A) An account maintained by foreign tourists for daily cash withdrawals in domestic currency and retail payment of local services.
 - (B) A specialized savings account offering high-interest rates exclusively for retail investors to encourage long-term capital growth.
 - (C) An account managed for a specific purpose via a tripartite agreement or understanding between multiple parties.
 - (D) An inter-bank borrowing account used to manage overnight liquidity shortages through the central bank's lending window.

Oct/Nov 2018

45. Consider the following statements concerning FPIs trading at GIFT City:
- I. Companies operating on IFSC exchanges do not pay securities transaction tax or commodity transaction costs.
 - II. All exchanges in the IFSC operate 22 hours a day and FPIs are permitted to operate without any additional documentation.

Which of the above statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2021

46. On which date was the International Financial Services Centres Authority (IFSCA) Bill, 2019 passed by the Lok Sabha, formalizing the framework for a unified regulator?
- (A) 27th April 2020
 - (B) 5th December 2019
 - (C) 1st April 2018
 - (D) 31st March 2021

but rather at the parent bank's consolidated level.

Under what specific regulatory condition is this practice considered compliant?

- (A) It is compliant only if the parent bank is a multinational corporation headquartered outside India with a high credit rating.
- (B) Compliant if the parent bank has permission from the IFSCA to maintain these ratios at the parent level.
- (C) It is strictly non-compliant as LCR and NSFR can under no circumstances be maintained outside the IBU level per global standards.
- (D) It is compliant only if the IBU maintains a compensatory 10% Cash Reserve Ratio with the RBI to offset localized liquidity risks.

May/June 2022

72. Arrange the following legislative acts in the chronological order of their enactment as referenced in the context of IFSC and international finance:

- I. Foreign Exchange Management Act (FEMA)
- II. Securities Transaction Tax under the Finance Act
- III. Special Economic Zones Act (SEZ Act)
- IV. IFSCA Act
- (A) I, III, II, IV
- (B) I, II, III, IV
- (C) II, I, IV, III
- (D) III, II, I, IV

Oct/Nov 2023

73. MegaBank's Parent Tier I Capital stands at USD 1 Billion. A single large corporate borrower approaches MegaBank's IBU for a massive infrastructure loan.

To comply with the exposure ceilings stipulated for IBUs, what is the maximum permissible loan exposure the IBU can take on this single borrower?

- (A) USD 10 Million
- (B) USD 50 Million
- (C) USD 100 Million
- (D) USD 200 Million

May/June 2020

74. Match the financial terms in List-I with their correct descriptions in List-II.

List I: (Financial Terms)

P. LCR

Q. Net Stable Funding Ratio

R. ADR

S. NDF

List II: (Descriptions)

- 1. A cash-settled short term forward contract where notional amount is never exchanged
- 2. American Depository Receipts
- 3. Relationship between liquid assets and short-term obligations
- 4. Relationship between company holding sufficient stable funds to cover duration of long term assets

(A) P-3, Q-4, R-2, S-1

(B) P-4, Q-3, R-1, S-2

(C) P-3, Q-4, R-1, S-2

(D) P-4, Q-3, R-2, S-1

Oct/Nov 2016

75. Apex Bank's IBU's Parent Tier I Capital stands at USD 1 Billion. The IBU now wishes to deploy these funds by investing in the debt instruments of a person resident in India.

According to the guidelines for resource deployment, what regulatory framework strictly governs this transaction?

- (A) The provisions of the Foreign Exchange Management Act (FEMA) 1999.
- (B) The Banking Regulation Act, 1949 and its subsequent amendments regarding inter-bank fund transfers.
- (C) The Securities and Exchange Board of India (SEBI) Act, 1992 concerning the issuance of debt instruments.
- (D) The State Government directives of Gujarat regarding industrial investment within special economic zones.

May/June 2014

76. Match the regulatory/statutory bodies in List-I with their domain as replaced by IFSCA in List-II.

List I: (Bodies)

P. SEBI

Q. PFRDA

R. IRDAI

S. RBI

List II: (Domains)

- 1. Insurance regulation
- 2. Securities and exchange regulation
- 3. Central banking and monetary regulation
- 4. Pension funds regulation

(A) P-2, Q-4, R-1, S-3

May/June 2012

54. Which of the following statements regarding the regulatory framework of IBUs is correct?
- (A) Leverage ratio for IBUs must be maintained exclusively at the IBU level as specified by IFSCA.
 - (B) IBUs are required to maintain a retail deposit reserve ratio on a weekly basis at 5% of outstanding deposits.
 - (C) IBUs are required to comply with the prudential directions issued by their home regulator unless otherwise specified by IFSCA.
 - (D) The parent bank is exempt from providing a letter of comfort regarding liquidity support to the IBU.

Oct/Nov 2024

55. A Parent Bank intending to set up an IBU must satisfy several conditions. Which of the following are correct?
- I. Maintain regulatory capital subject to a minimum of USD 20 Million at the Parent Bank level.
 - II. Obtain a No Objection letter from the home country regulator.
 - III. Provide a Letter of comfort regarding liquidity and resource support to the IBU.
 - IV. Register as a non-banking financial company with the IFSCA.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
 - (B) II, III, and IV
 - (C) I, III, and IV
 - (D) I, II, and IV

May/June 2017

56. Which statement accurately reflects the operational aspects of deposits in IBUs?
- (A) Indian KYC-AML and delinquency norms are applicable to IBUs.
 - (B) Deposits in IBUs are fully insured by domestic deposit insurance agencies.
 - (C) IBUs can accept cash deposits up to USD 10,000 per transaction.
 - (D) Savings bank accounts can be opened by resident individuals in IBUs.

Oct/Nov 2015

57. Examine the following statements about the scope and operations of IFSCs:
- I. IFSCs cater to customers outside the

jurisdiction of the domestic economy.

- II. They deal with flows of finance, financial products, and services across borders.
- III. Banks in IFSCs seek deposits from resident citizens.
- IV. An IFSC can be set up in an SEZ after obtaining approval from the Central Government.
- V. Securities transactions entered by non-residents through an IFSC enjoy exemption from Securities Transaction Tax.

Which of the above statement(s) is/are correct?

- (A) I, II, IV, and V
- (B) I, II, III, and IV
- (C) II, III, IV, and V
- (D) I, III, IV, and V

May/June 2013

58. Which of the following statements about the licensing and setting up of IBUs by Indian banks is incorrect?
- (A) Banks in both the Public Sector and Private Sector authorized to deal in foreign exchange are eligible to set up IBUs.
 - (B) Each eligible bank is permitted to set up multiple IBUs within a single IFSC to boost business volume.
 - (C) Eligible banks must obtain prior permission from the RBI/IFSCA for opening an IBU.
 - (D) For most regulatory purposes, an IBU is treated on par with a foreign branch of an Indian bank.

Oct/Nov 2019

59. Identify the correct statements concerning the regulatory and operational guidelines of IBUs:
- I. IBUs are strictly required to maintain SLR and CRR.
 - II. Leverage ratio may be maintained by the Parent Bank at the level specified by the home regulator.
 - III. Retail deposit reserve ratio must be maintained daily at 3% of deposits raised from individuals.
 - IV. IBUs can undertake transactions with residents for deployment of funds.
 - V. IBUs can deal with Wholly Owned Subsidiaries of Indian companies registered abroad.

Which of the above statement(s) is/are correct?

- (A) II, III, IV, and V
- (B) I, II, III, and IV

but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

25. The operations of an IBU are subject to specific restrictions. Which of the following facilities is NOT permitted for IBUs?

- (A) Utilizing the domestic onshore payment systems for core foreign currency settlements.
(B) Offering derivative products after obtaining prior approval from the regulator.
(C) Operating a special rupee account to defray statutory expenses.
(D) Maintaining separate Nostro accounts distinct from other branches of the same bank.

May/June 2017

26. The following questions consist of two statements—an Assertion (A) and a Reason (R). Answer the questions by selecting the appropriate option.

Assertion (A): The loans and advances disbursed by an IBU are reckoned as part of the Net Bank Credit of the Parent Bank for computing priority sector lending obligations.

Reason (R): IBUs are primarily offshore banking units meant to facilitate cross-border financial transactions and are treated as foreign branches of the parent bank.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

27. What is the main objective of establishing an International Financial Service Centre (IFSC) in India?

- (A) To develop a strong global connect and serve as an international destination for Corporates' financial activities.
(B) To redirect all domestic rural credit to foreign portfolio investors to stimulate international investment in agriculture.

- (C) To act as a clearinghouse exclusively for domestic inter-bank transactions in Indian Rupees and specialized sovereign bonds.

- (D) To eliminate the need for foreign exchange reserves management by the Reserve Bank of India through automated market mechanisms.

May/June 2020

28. GlobalTrust Bank operates an IBU at GIFT City. At the end of the financial quarter, the compliance officer is computing the mandatory reserve requirements. The parent bank insists that a portion of the IBU's liabilities must be parked with the RBI to meet the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) norms to avoid penal action.

How should the compliance officer appropriately respond to the parent bank?

- (A) The IBU must immediately comply and maintain CRR and SLR strictly in foreign currencies with the RBI to avoid penalties.
(B) The IBU should inform the parent bank that only 50% of the standard CRR and SLR applies to IFSC operations for the first year.
(C) Clarify that IBU liabilities are exempt from both CRR and SLR requirements of the RBI.
(D) The IBU must maintain CRR and SLR with the IFSCA instead of the RBI to ensure specialized regulatory compliance.

Oct/Nov 2015

29. What is the primary operational reason for establishing the IFSCA as a unified regulatory authority?

- (A) To strictly isolate foreign banks from participating in the Indian financial sector to protect domestic interests from volatility.
(B) The need for inter-regulatory coordination to promote ease of doing business and provide a world-class environment.
(C) To allow domestic banks to bypass the RBI's stringent monetary policy frameworks entirely and operate under offshore laws.
(D) To shift the burden of domestic inflation control from the central government to an autonomous body with global oversight.

May/June 2013

30. Mr. Sharma, a high-net-worth individual (HNI) residing in Dubai, visits an IBU in GIFT City to open an account for wealth management

Assertion (A).

- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2006

66. The parent bank of an IBU is subject to several conditions under the regulatory framework. Which of the following is NOT one of these conditions?
- (A) Maintaining a minimum regulatory capital of USD 20 Million at the Parent Bank level.
 - (B) Obtaining a No Objection letter from the home country regulator.
 - (C) Submitting daily transaction logs of all domestic retail customers to IFSCA.
 - (D) Providing a letter of comfort regarding liquidity and resource support to the IBU.

Oct/Nov 2017

67. Alpha Private Bank, authorized to deal in foreign exchange, wishes to expand its footprint by establishing a presence in GIFT City. The bank's board proposes to open three separate branches within the same IFSC to cater to different operational segments: retail, corporate, and treasury. Based on the regulatory guidelines for setting up IBUs, what is the fundamental flaw in the board's proposal?
- (A) An eligible bank is permitted to set up only one IBU in each IFSC, rendering the proposal for three branches invalid.
 - (B) Private sector banks are completely ineligible to set up IBUs; only public sector banks possess this eligibility.
 - (C) The bank must first surrender its domestic foreign exchange authorization before opening an IBU.
 - (D) IBUs are strictly prohibited from engaging in any corporate or treasury management operations.

May/June 2008

68. Which of the following best describes 'Tier I Capital' of a bank in the context of calculating exposure ceilings for an IBU?
- (A) The aggregate of subordinated debt and revaluation reserves of the bank.
 - (B) The core capital of the bank, comprising

exclusively of short-term liquid assets.

- (C) The mandatory deposits kept with the central bank under the Cash Reserve Ratio.
- (D) The core capital of the bank, which includes Equity plus reserves and surplus.

Oct/Nov 2013

69. XYZ Corp, a resident Indian corporate entity heavily engaged in importing raw materials, approaches an IBU in GIFT City seeking a short-term foreign currency loan to finance its immediate trade transactions. The IBU manager is unsure if lending to a resident corporate entity is permissible. Based on the scope of IFSC in India, what is the correct regulatory stance?
- (A) IBUs are strictly prohibited from lending to any resident corporate entity under all circumstances.
 - (B) IBUs can lend to resident corporates only if the loan is disbursed and repaid exclusively in Indian Rupees.
 - (C) IBUs can only lend to resident corporates if the corporate relocates its headquarters to the SEZ.
 - (D) IBUs are permitted to lend in foreign currencies to resident corporates specifically for trade transactions.

May/June 2015

70. What signifies the strategic importance of the Indian diaspora in the context of GIFT City's opportunities?
- (A) They are mandated by law to remit all their foreign earnings directly through IFSC banking units to boost national reserves.
 - (B) They are the only entities permitted to open savings bank accounts in GIFT City under a special regulatory carve-out.
 - (C) Connecting the 30 million diaspora with USD 3 trillion worth provides massive inbound and outbound financial routing potential.
 - (D) They provide the exclusive workforce required to run Global in-house Centers and specialized financial technology startups.

Oct/Nov 2012

71. Zenith Bank's IBU is undergoing an audit. The auditors note that the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are not being maintained at the IBU branch level,

- Q. Capital markets
- R. Retail Banking
- S. Treasury management

List II: (Activities)

1. Consolidate group-wise derivative trading, including NDF in INR
2. Equipment leasing and Credit enhancement
3. Funding of alternative investment funds and custodian of securities
4. Wealth management and structured deposits

- (A) P-2, Q-3, R-4, S-1
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

May/June 2008

36. A Foreign Portfolio Investor (FPI) registered in India decides to execute a series of high-volume short-term derivative trades on an exchange operating within GIFT City. Under standard domestic taxation, such trades attract a 30% short term capital gains tax.

What tax implication will the FPI face for executing these specific trades on the IFSC exchange?

- (A) The FPI will be subjected to a double taxation penalty due to cross-border jurisdiction rules.
- (B) The FPI will have to pay a reduced short term capital gains tax of 15%.
- (C) The FPI must pay the standard 30% tax but is exempt from filing any tax returns.
- (D) The FPI will enjoy a complete waiver of the short term capital gains tax on the derivatives trade.

Oct/Nov 2013

37. Match the specific financial accounts or entities in List-I with their appropriate features in List-II.

List I: (Accounts/Entities)

- P. WOS
- Q. Escrow account
- R. SNRR account
- S. JVs

List II: (Features)

1. Account funded only by foreign currency remittances through international channel
2. Equity contribution in a foreign entity invested by the Indian Party entirely
3. Opened for a specific purpose involving a

tripartite agreement

4. Equity contribution in a foreign entity invested both by Indian Party and Overseas entity

- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

May/June 2015

38. An IBU has successfully raised deposits from various high-net-worth individuals. At the end of a working day, the total outstanding deposits raised from these individuals amounts to USD 10 Million.

What is the immediate regulatory obligation of the IBU regarding a retail deposit reserve ratio on the following working day?

- (A) The IBU must immediately repatriate USD 300,000 back to the depositors to comply with daily liquidity constraints.
- (B) The IBU must convert 5% of these deposits into Indian Rupees and park them with the RBI to satisfy statutory reserves.
- (C) The IBU must maintain a daily retail deposit reserve ratio of 3% (USD 300,000) of these deposits.
- (D) The IBU faces no specific reserve requirement since SLR and CRR are entirely exempted under the current IFSC framework.

Oct/Nov 2012

39. Which of the following pairs of 'Regulatory Framework feature' and 'Applicability to IBU' is CORRECTLY matched?

- (A) Liabilities of the IBU : Exempt from both CRR and SLR requirements of RBI
- (B) Retail deposit reserve ratio : 5% calculated on a weekly basis
- (C) Leverage ratio : Must be maintained strictly at the branch level independently
- (D) Minimum capital requirement : USD 50 Million at the IBU level

May/June 2012

40. An IBU aims to expand its treasury management portfolio by offering complex foreign exchange derivative products to its non-resident institutional clients.

Before rolling out these new derivative offerings, what crucial regulatory step must the IBU

- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2020

77. A foreign bank from the UK wishes to set up an IBU in GIFT City. It fulfills the capital requirements but fails to produce a No Objection Certificate (NOC) from the Financial Conduct Authority (its home country regulator). It instead offers an expanded Letter of Comfort. Will IFSCA grant the license to set up the IBU?
- (A) Yes, an expanded Letter of Comfort legally supersedes the requirement for a home country NOC.
 - (B) No, obtaining a No Objection letter from the home country regulator is a mandatory condition for the parent bank.
 - (C) Yes, foreign banks are exempt from NOC requirements; only Indian banks require an NOC from the RBI.
 - (D) No, the bank must instead merge with a domestic Indian bank to bypass the NOC requirement.

May/June 2011

78. Match the regulatory limits or conditions in List-I with their corresponding values or descriptions in List-II.
- List I: (Limits/Conditions)
- P. Retail deposit reserve ratio
 - Q. Exposure ceiling for Single borrower
 - R. Exposure ceiling for a borrower group
 - S. Parent Bank Capital requirement
- List II: (Values/Descriptions)
- 1. 10% of parent Bank Tier I Capital
 - 2. Minimum USD 20 Million
 - 3. 5% of parent Bank Tier I Capital
 - 4. 3% of deposits raised from individuals outstanding daily
- (A) P-4, Q-3, R-1, S-2
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-4, Q-2, R-3, S-1

Oct/Nov 2005

79. A globally active institutional investor wishes to trade continuously across Asian, European, and American market hours to capitalize on real-time news. They are evaluating the exchanges at GIFT City.
- Which operational relaxation provided at GIFT

City makes it highly suitable for this investor's strategy?

- (A) Exchanges at GIFT City operate for a restricted 8-hour window but process trades instantly through a unified digital clearing house.
- (B) The exchanges allow trades to be settled entirely in physical gold bars, bypassing time zones and standard currency fluctuations.
- (C) Investors are permitted to manipulate market prices during non-business hours without regulatory scrutiny from the unified authority.
- (D) Exchanges operate 22 hours a day and FPIs are permitted to operate without any additional documentation.

May/June 2018

80. Identify the correctly matched pair regarding the permissible activities at an IBU.
- (A) Cheque facility : Available for all current accounts maintained by corporate entities in the SEZ.
 - (B) Denomination of transactions : Conducted exclusively in Indian Rupees for all payments.
 - (C) Liquidity support : Readily available from the Reserve Bank of India.
 - (D) SNRR accounts : Funded strictly by foreign currency remittances through international channels.

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ANSWERS

1. (B) Reject the deposit, as SNRR accounts must be funded strictly by foreign currency remittances through international channels.
IFSC Banking Units maintain Special Non-Resident Rupee accounts to facilitate international inward remittances. These accounts are strictly regulated and must be funded solely through foreign currency remittances received from international channels. Direct deposits in Indian Rupees by domestic corporate clients are not permitted as they violate the fundamental funding structure designed for offshore banking operations.
2. (C) Section 98 of Finance Act 2004 : Levies double taxation on non-residents in IFSC
The regulatory framework for GIFT City includes several tax incentives to attract global investors. However, Section 98 of the Finance Act 2004 does not levy double taxation on non-residents in the IFSC. In reality, entities within the IFSC benefit from significant tax exemptions, such as waivers on securities transaction taxes, to enhance competitiveness and encourage cross-border financial activity.
3. (A) A cash-settled, short-term forward contract where the notional amount is never exchanged.
Non-Deliverable Forwards are short-term, cash-settled forward contracts where the notional principal amount is never physically exchanged between the parties involved. Instead, the net difference between the agreed-upon exchange rate and the prevailing spot rate at maturity is settled in a convertible currency. This derivative instrument is widely used to hedge against fluctuations in non-convertible currencies.
4. (D) Neither I nor II
Loans and advances issued by IFSC Banking Units are treated as transactions of foreign branches and are not reckoned as part of the parent bank's Net Bank Credit for priority sector lending obligations. Furthermore, the Reserve Bank of India does not provide a special liquidity support window for these units, as they are expected to be self-reliant.
5. (D) An entity where the entire equity contribution in a foreign entity is invested by the Indian Party.
A Wholly Owned Subsidiary in international business refers to an entity where the entire equity contribution is invested by the Indian Party. This structure differs from a Joint Venture, which involves shared equity between domestic and overseas entities. WOS entities allow for full control over operations and profits while facilitating global expansion and adherence to international regulatory requirements.
6. (B) Only II
IFSC Banking Units are prohibited from opening savings bank accounts for any customer. However, they are required to maintain distinct Nostro accounts with correspondent banks for their foreign currency transactions. These accounts must be separate from the Nostro accounts held by other branches of the parent bank to ensure clear accounting and effective tracking of offshore financial activities.
7. (B) 225 companies, including 3 PSBs, 9 Private Sector Banks, and 3 MNC Banks.
During its early operational phase, GIFT City emerged as a major financial hub with approximately 225 companies establishing their presence. This group included a diverse mix of banking institutions, specifically three Public Sector Banks, nine Private Sector Banks, and three Multi-National Banks. This multi-layered institutional setup was crucial for developing a robust ecosystem for international financial services and cross-border transactions.
8. (B) II and III
Indian banks, whether public or private, are eligible to establish IFSC Banking Units provided they are authorized to deal in foreign exchange. Each eligible bank can set up only one such unit in each IFSC. Furthermore, any deployment of funds with persons resident in India must strictly adhere to the provisions of the Foreign Exchange Management Act.

9. (B) USD 20 Million or equivalent in any foreign currency

To ensure financial stability and operational capability, the parent bank must provide a minimum capital of USD 20 million or its equivalent in any foreign currency to its IFSC Banking Unit. This capital must be maintained at all times to support the unit's specialized offshore banking activities and to comply with the regulatory standards established by the authority.

10. (A) I and II

Regulatory compliance for IFSC Banking Units involves specific liquidity and reserve requirements. The Liquidity Coverage Ratio and Net Stable Funding Ratio can be maintained at the parent level with permission from the IFSCA. Additionally, these units must maintain a daily retail deposit reserve ratio of three percent on all deposits raised from individuals to manage localized liquidity risks effectively.

11. (A) IBUs cannot engage in cash transactions and are not designed for traditional domestic retail banking needs.

IFSC Banking Units are designed as offshore hubs focusing on high-value cross-border transactions rather than traditional domestic retail banking. Consequently, they are prohibited from opening savings bank accounts. These units do not engage in physical cash transactions, and their operational framework is tailored for corporate and institutional financial services, necessitating the exclusion of standard retail savings facilities for individual customers.

12. (A) I, II, and III

International Financial Service Centres focus on diverse global financial activities, including fund raising for various entities, asset management, and global portfolio diversification. They also facilitate global tax management and cross-border liability optimization. However, domestic micro-finance lending and agricultural subsidies are not within their scope, as these centers are primarily intended to manage international capital flows and sophisticated offshore financial products.

13. (B) IFSC banks operate like foreign branches and are exempt from domestic reserve requirements (CRR/SLR).

Banks operating within an IFSC are treated similarly to foreign branches rather than domestic branches. As a result, they are exempt from domestic reserve requirements such as the Cash Reserve Ratio and the Statutory Liquidity Ratio usually mandated by the central bank. This exemption allows these units to remain globally competitive and provides them with greater flexibility in managing their liquidity.

14. (B) II, III, and IV

IFSC Banking Units can maintain deposits through current accounts and term deposits, following strict KYC-AML and delinquency norms. Notably, deposits held with these units are not covered by domestic deposit insurance. Furthermore, cash transactions are generally not permitted, as the operational framework relies on digital bank transfers to ensure transparency and security in handling large-scale international financial transactions.

15. (D) Connecting a 30 million strong Indian diaspora with a combined worth of USD 3 trillion to India through the IFSC.

GIFT City presents a massive business opportunity by connecting the thirty million strong Indian diaspora to India's financial markets. With a combined net worth estimated at three trillion US dollars, this diaspora represents a significant source of inbound and outbound capital. The IFSC serves as a strategic gateway for routing these global funds, enhancing investment flows and international financial connectivity.

16. (A) I, II, and III

To manage credit risk, IFSC Banking Units adhere to strict exposure ceilings based on the parent bank's Tier One Capital. For a single borrower, the ceiling is five percent, while for a borrower group, it is ten percent. These units are regulated and supervised by the RBI or IFSCA and must maintain their balance sheets strictly in foreign currency.

17. (B) FPIs are allowed to trade in commodity derivatives on IFSC exchanges.

Foreign Portfolio Investors operating within the GIFT City IFSC benefit from significant regulatory

- 67.** (A) An eligible bank is permitted to set up only one IBU in each IFSC, rendering the proposal for three branches invalid.
The proposal to open three separate branches within a single IFSC is invalid because regulatory guidelines permit each eligible bank to set up only one IFSC Banking Unit in each center. While the unit can undertake various operations such as retail, corporate, and treasury services, these must be conducted through a single licensed entity to ensure streamlined oversight and regulatory compliance.
- 68.** (D) The core capital of the bank, which includes Equity plus reserves and surplus.
Tier One Capital represents the core capital of a bank and is used as a benchmark for calculating exposure ceilings. It primarily consists of common equity, disclosed reserves, and surplus funds. This capital provides the most reliable cushion against potential losses and ensures that the bank can absorb risks arising from its lending and investment activities within the IFSC Banking Unit's operations.
- 69.** (D) IBUs are permitted to lend in foreign currencies to resident corporates specifically for trade transactions.
Within the operational scope of an IFSC, Banking Units are permitted to lend in foreign currencies to resident corporate entities, provided the funds are used specifically for trade transactions. This facility allows Indian importers and exporters to access foreign currency financing more efficiently. All such lending activities must adhere to the regulations established by the IFSCA and the Foreign Exchange Management Act.
- 70.** (C) Connecting the 30 million diaspora with USD 3 trillion worth provides massive inbound and outbound financial routing potential.
The thirty million strong Indian diaspora, with a collective worth of three trillion US dollars, represents a massive opportunity for GIFT City. By serving as a strategic hub for this community, the IFSC can facilitate significant inbound and outbound financial routing. This potential for capital flow makes the diaspora a key target group for the various wealth management and investment services offered within the center.
- 71.** (B) Compliant if the parent bank has permission from the IFSCA to maintain these ratios at the parent level.
Maintaining the Liquidity Coverage Ratio and Net Stable Funding Ratio at the parent bank's consolidated level is only compliant if the unit has obtained specific permission from the IFSCA. Without such authorization, these ratios are typically expected to be managed at the individual unit level. This flexibility allows the regulator to balance localized liquidity needs with the overall strength of the parent bank.
- 72.** (B) I, II, III, IV
The development of the financial regulatory landscape followed a specific chronological order: the Foreign Exchange Management Act (FEMA), the implementation of Securities Transaction Tax, the Special Economic Zones Act (SEZ Act), and finally the enactment of the IFSCA Act. Each of these legislative steps built upon the previous ones to create the current robust and unified framework for international financial services in India.
- 73.** (B) USD 50 Million
Exposure ceilings for IFSC Banking Units are calculated as a percentage of the parent bank's Tier One Capital. For a single borrower, the maximum permissible exposure is limited to five percent of that capital. Given a parent Tier One Capital of one billion US dollars, the IBU can take a maximum loan exposure of fifty million US dollars on a single corporate borrower.
- 74.** (A) P-3, Q-4, R-2, S-1
Financial terms denote specific ratios and instruments. The Liquidity Coverage Ratio measures the relationship between liquid assets and short-term obligations. The Net Stable Funding Ratio ensures that a company holds enough stable funds to cover long-term assets. American Depositary Receipts facilitate foreign investment in US markets. Non-Deliverable Forwards are cash-settled contracts where the notional principal amount is never physically exchanged between the trading parties.
- 75.** (A) The provisions of the Foreign Exchange Management Act (FEMA) 1999.
Any deployment of funds by an IFSC Banking Unit with persons resident in India is strictly

maintain special Rupee accounts for expenses, their primary transaction infrastructure must remain separate from the standard domestic retail payment architecture.

- 26.** (D) Assertion (A) is false, but Reason (R) is true. The loans and advances disbursed by an IFSC Banking Unit are not included in the Net Bank Credit of the parent bank for priority sector lending purposes. This is because these units are treated as offshore entities or foreign branches. Their primary mission is to facilitate international and cross-border transactions, distinguishing them from domestic branches that must fulfill national credit obligations.
- 27.** (A) To develop a strong global connect and serve as an international destination for Corporates' financial activities. The establishment of an International Financial Service Centre in India aims to create a globally connected hub for international financial activities. By offering world-class infrastructure and a conducive regulatory environment, the IFSC serves as a premier destination for global corporations to manage their finances. This helps in attracting foreign investment and positioning India as a significant player in the global financial market.
- 28.** (C) Clarify that IBU liabilities are exempt from both CRR and SLR requirements of the RBI. According to the regulatory framework, IFSC Banking Units operate like foreign branches and are not subject to the domestic reserve requirements of the Reserve Bank of India. Therefore, the compliance officer should clarify that the unit's liabilities are exempt from both the Cash Reserve Ratio and the Statutory Liquidity Ratio. This exemption is fundamental to maintaining the global competitiveness of the center.
- 29.** (B) The need for inter-regulatory coordination to promote ease of doing business and provide a world-class environment. The IFSCA was established to serve as a unified regulatory authority, addressing the need for inter-regulatory coordination within the IFSC. This structure promotes ease of doing business by providing a single-window clearance system and a consistent regulatory environment. By

harmonizing rules across banking, securities, and insurance, the IFSCA creates a world-class environment that attracts global investors and financial institutions.

- 30.** (C) Decline both requests, as SB accounts are not allowed and no cheque facility is available in IBUs. Regulatory guidelines for IFSC Banking Units strictly prohibit the opening of savings bank accounts for any individual or corporate customer. Additionally, these units do not provide cheque book facilities, as all financial movements are required to be conducted via bank transfers. Therefore, the bank must decline both the request for a savings account and the request for a cheque book facility.
- 31.** (D) By maintaining a special rupee account through an Authorized Dealer, subject to foreign exchange regulations. IFSC Banking Units primarily operate in foreign currencies but must cover local administrative and statutory costs within India in Indian Rupees. To do this legally, they maintain a special Rupee account through an Authorized Dealer. This account is specifically designated for defraying these localized expenses and must be managed in accordance with the prevailing foreign exchange regulations of the country.
- 32.** (D) A foreign currency Escrow account designated for temporary subscriptions to GDR issues. For specialized purposes such as managing temporary subscriptions for a Global Depository Receipt issue, IFSC Banking Units are permitted to open foreign currency escrow accounts. These accounts are governed by tripartite agreements and ensure that funds are held securely until the issuance process is finalized. This facility supports resident Indian entities in accessing international capital markets efficiently while adhering to offshore regulations.
- 33.** (A) I, II, III The evolution of GIFT City began with the enactment of the Special Economic Zones Act, which created the necessary legal framework for experimental reforms. Subsequently, GIFT City commenced its operations in Gandhinagar to serve as a financial hub. Finally, the International Financial Services Centres Authority was

relaxations. One such benefit is the permission to trade in commodity derivatives on exchanges operating within the center. These investors also enjoy exemptions from several domestic taxes, such as securities transaction taxes and short-term capital gains taxes on derivative trades, which incentivizes higher trading volumes and market liquidity.

18. (A) I, II, III, and V

IFSC Banking Units must conduct all transactions in currencies other than Indian Rupees. They can open foreign currency current accounts for corporate borrowers without providing cheque facilities. Additionally, these units are permitted to act as underwriters for Rupee-denominated overseas bonds issued by Indian entities. However, undertaking derivative products requires prior regulatory approval, ensuring that sophisticated financial instruments are managed with appropriate oversight.

19. (A) IBUs are permitted to participate in the Indian domestic call, notice, and term money markets.
IFSC Banking Units are offshore entities and are generally prohibited from participating in domestic Indian call, notice, and term money markets. Their operations are restricted to foreign currency transactions to prevent interference with domestic monetary policy. They are, however, allowed to provide factoring and forfaiting services for export receivables and act as underwriters for specific overseas bonds issued by Indian entities.

20. (A) I, III, IV, and V

Registered Foreign Portfolio Investors are allowed to trade on IFSC exchanges, which operate twenty-two hours a day to accommodate global time zones. These entities do not pay securities transaction taxes, and retail investors are permitted to participate to build market liquidity. Unlike domestic markets, FPIs are not barred from trading in commodity derivatives, making GIFT City an attractive destination for investors.

21. (D) Current accounts in IBUs are provided with standard cheque book facilities to ease corporate transactions.
IFSC Banking Units are restricted in their retail banking offerings to maintain the integrity of offshore financial flows. Consequently, current

accounts in these units do not come with standard cheque book facilities. All transactions must be conducted through secure bank transfers. However, these units can maintain special rupee accounts for administrative costs and open escrow accounts for specific capital market issues.

22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Special Economic Zones provide a controlled environment to test financial reforms before they are implemented nationwide. This is particularly important in India, where partial capital account convertibility and high reserve requirements exist. By using these zones for experimentation, regulators can assess the impact of liberalized policies without exposing the broader domestic economy to potential risks or immediate large-scale volatility during transitions.

23. (B) Competition Commission of India (CCI)

Before the establishment of the IFSCA, financial activities in the IFSC were governed by existing domestic regulators based on the type of business. The RBI, SEBI, IRDAI, and PFRDA each managed their respective sectors. The Competition Commission of India, while a regulatory body, was never involved in the direct day-to-day oversight or licensing of financial products within the offshore center.

24. (D) Assertion (A) is false, but Reason (R) is true.
IFSC Banking Units are mandated to maintain and operate their balance sheets exclusively in foreign currency, not in Indian Rupees. However, to manage local operational requirements, they are permitted to open a special Rupee account. This account is used solely for paying localized administrative and statutory expenses, ensuring that their primary financial operations remain insulated from the domestic currency while meeting obligations.

25. (A) Utilizing the domestic onshore payment systems for core foreign currency settlements.
IFSC Banking Units are prohibited from using domestic onshore payment systems for their core foreign currency settlements. These settlements must be handled through international channels to maintain the offshore nature of the unit. While they can offer derivatives with approval and

maintaining balance sheets in foreign currency and applying FEMA regulations to corporate current accounts, are correctly associated with IBU operations.

- 42.** (B) A center for customers outside the domestic economy, handling cross-border financial flows. An International Financial Service Centre is a specialized zone designed to cater to customers located outside the jurisdiction of the domestic economy. It facilitates the flow of finance, financial products, and services across international borders. These centers operate under a distinct regulatory framework that allows for greater liberalisation and connectivity with global financial markets compared to the traditional domestic financial system.
- 43.** (C) Both I and II
Parent banks setting up an IFSC Banking Unit are required to provide a minimum capital of twenty million US dollars or its equivalent in a foreign currency. This capital infusion is a mandatory condition for licensing and must be maintained by the unit at all times. Such capital requirements ensure that the unit remains solvent and can support its international banking operations.
- 44.** (C) An account managed for a specific purpose via a tripartite agreement or understanding between multiple parties.
An escrow account is a specialized financial arrangement where funds are held by a third party on behalf of two other parties who are in the process of completing a transaction. In the context of an IFSC, these accounts are managed for specific purposes through tripartite agreements or understandings, ensuring that funds are only released when predetermined conditions are met.
- 45.** (C) Both I and II
Companies operating on IFSC exchanges benefit from exemptions on securities transaction taxes and commodity transaction costs. Furthermore, these exchanges operate for twenty-two hours a day, allowing for continuous global trading. Registered Foreign Portfolio Investors can operate on these exchanges without needing additional documentation, which significantly enhances the ease of doing business and promotes higher liquidity within the international financial hub.

- 46.** (B) 5th December 2019
The International Financial Services Centres Authority Bill, 2019 was passed by the Lok Sabha on December 5, 2019. This landmark legislation paved the way for the creation of a unified regulatory authority to oversee the development and regulation of financial products, services, and institutions within India's IFSCs. This was a critical step in streamlining the governance of offshore financial activities.
- 47.** (A) I and II
Banks within an IFSC operate as foreign branches of their parent banks and are permitted to lend in foreign currencies to resident corporates specifically for trade-related transactions. However, they are not subject to stringent domestic reserve requirements like CRR and SLR. Instead, they enjoy a more liberalized regulatory environment designed to facilitate international financial services and attract global capital flows.
- 48.** (B) 27th April 2020
The International Financial Services Centres Authority was officially established on April 27, 2020. Headquartered in Gandhinagar, Gujarat, it was created under the IFSCA Act of 2019 to act as a unified regulator for all financial activities within India's IFSCs. This establishment consolidated the powers of various domestic regulators into a single body to ensure better coordination and market growth.
- 49.** (A) I and II
Established on April 27, 2020, under the IFSCA Act 2019, the authority serves as a unified regulator for financial products in the IFSC. Prior to its establishment, various domestic regulators like the RBI and SEBI oversaw different business segments within the center. The IFSCA was created to provide a more streamlined and cohesive regulatory framework, fostering a world-class financial environment.
- 50.** (C) It permits testing reforms before national rollout due to existing restrictions like capital convertibility and high SLR.
Special Economic Zones serve as ideal testing grounds for financial reforms because they provide a controlled environment to trial new policies before national implementation. This is particularly useful in India, where existing

restrictions like high statutory liquidity ratios and partial capital account convertibility make large-scale reforms complex. Testing in these zones allows for the identification and resolution of potential issues safely.

51. (A) I and II

IFSC Banking Units are authorized to undertake specific activities such as factoring and forfaiting of export receivables to support international trade. They must strictly follow all AML and CFT instructions issued by the regulator to ensure financial integrity. However, they are not permitted to issue cheque books for domestic payments, as their primary operations are restricted to electronic transfers in foreign currencies.

52. (D) To defray their administrative and statutory expenses in Indian Rupees.

Although IFSC Banking Units primarily operate in foreign currency, they must fulfill certain local obligations within India. The purpose of maintaining a Special Rupee Account is to defray their local administrative and statutory expenses in Indian Rupees. This ensures that the units can pay for utilities, rent, and salaries while keeping their main offshore banking operations separate from the domestic currency system.

53. (A) I, II, and III

GIFT City offers numerous opportunities, including access to international markets and becoming a hub for Global In-house Centers with competitive costs. It is also emerging as a leading destination for fund administration. However, there is no requirement for foreign corporations to shift their primary headquarters to India. Instead, the focus is on providing a gateway for global financial operations and investments.

54. (C) IBUs are required to comply with the prudential directions issued by their home regulator unless otherwise specified by IFSCA.
IFSC Banking Units are generally required to comply with the prudential directions issued by their home country regulator, unless the IFSCA specifies otherwise. This ensures a consistent standard of safety and soundness. While certain ratios like the retail deposit reserve ratio are set at three percent daily, the overarching prudential

framework relies heavily on the standards established by the parent bank's regulator.

55. (A) I, II, and III

A parent bank must meet several conditions to establish an IFSC Banking Unit, including maintaining a minimum regulatory capital of twenty million US dollars. It must also obtain a No Objection letter from its home country regulator and provide a letter of comfort regarding liquidity support. These requirements ensure that the unit is well-capitalized and has the full backing of its parent.

56. (A) Indian KYC-AML and delinquency norms are applicable to IBUs.

Operations in IFSC Banking Units are subject to strict regulatory standards, including the application of Indian KYC-AML and delinquency norms. These units cannot open savings bank accounts for resident individuals or accept physical cash deposits. Furthermore, deposits held in these units are not insured by domestic agencies, highlighting the importance of robust risk management and adherence to international financial compliance standards.

57. (A) I, II, IV, and V

IFSCs focus on international customers and cross-border financial flows. They can be established within Special Economic Zones with government approval. Notably, non-residents conducting securities transactions through an IFSC enjoy exemptions from the Securities Transaction Tax. However, these units do not seek deposits from resident citizens, as their mandate is primarily to serve as an offshore hub for global financial services and capital.

58. (B) Each eligible bank is permitted to set up multiple IBUs within a single IFSC to boost business volume.

The regulatory guidelines for IFSC Banking Units specify that each eligible bank is permitted to set up only one such unit in each IFSC. Therefore, the statement that a bank can set up multiple units within a single IFSC is incorrect. Both public and private sector banks can apply for a license, and for most purposes, these units are treated as foreign branches.

- 59.** (A) II, III, IV, and V
IFSC Banking Units are exempt from domestic CRR and SLR requirements. They must maintain a daily retail deposit reserve ratio of three percent on individual deposits. Furthermore, they are permitted to undertake transactions with residents for fund deployment and deal with Wholly Owned Subsidiaries of Indian companies registered abroad. The leverage ratio is typically maintained by the parent bank according to home regulator specifications.
- 60.** (C) Liquidity Coverage Ratio and Net Stable Funding Ratio must be maintained at the IBU level with no exceptions.
It is incorrect to state that the Liquidity Coverage Ratio and Net Stable Funding Ratio must always be maintained at the IBU level without exception. In fact, these ratios may be maintained at the parent level if permission is obtained from the IFSCA. Other requirements, such as obtaining a home country NOC and providing regulatory capital, are mandatory conditions for parent banks.
- 61.** (A) I, II, IV, and V
Key financial terms include External Commercial Borrowings for capital expansion and Asset Liability Management for risk mitigation. The Cash Reserve Ratio involves maintaining specific funds with the central bank, while escrow accounts are used for tripartite agreements. Notably, the description of Non-Deliverable Forwards is correct only if the notional amount is not exchanged, as settlement is based on the exchange rate difference.
- 62.** (C) Retail deposit mobilization via savings accounts.
Wholesale banking at GIFT City focuses on large-scale corporate services such as External Commercial Borrowings, trade finance, and guarantee businesses. It also includes factoring and forfaiting for export receivables. However, retail deposit mobilization through savings accounts is not part of this segment. Savings accounts are prohibited in the IFSC framework to keep the center's focus on international and institutional financial activities.
- 63.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
IFSC Banking Units do not provide cheque facilities for current accounts, as all financial transactions must be conducted via digital bank transfers. This requirement ensures that all cross-border movements of money are strictly tracked and documented, facilitating better oversight and security. Therefore, the lack of cheque books is a deliberate operational choice intended to maintain the integrity of the offshore banking environment.
- 64.** (D) Providing liquidity support to other domestic branches of the parent bank using RBI funds.
IFSC Banking Units are prohibited from providing liquidity support to domestic branches of their parent bank using funds from the Reserve Bank of India. These units are meant to be offshore entities focusing on international business. They can deal with overseas subsidiaries and open foreign currency accounts for IFSC units, but their financial resources must remain separated from the domestic inter-bank market.
- 65.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The establishment of the IFSCA as a unified regulator was essential for the growth of the IFSC. Managing such a center requires significant inter-regulatory coordination across banking, securities, and insurance. By consolidating these functions, the IFSCA promotes ease of doing business and provides a world-class regulatory environment. This holistic approach helps in attracting international financial institutions and ensuring market efficiency within the zone.
- 66.** (C) Submitting daily transaction logs of all domestic retail customers to IFSCA.
Parent banks must meet specific conditions to operate an IFSC Banking Unit, such as providing minimum capital and obtaining an NOC from their home regulator. They must also provide a letter of comfort regarding liquidity support. However, they are not required to submit daily transaction logs of all domestic retail customers to the IFSCA, as retail savings accounts are generally not permitted.

established as a unified regulator to oversee and develop financial products within these specialized centers.

- 34.** (C) By maintaining a special rupee account through an Authorized Dealer, subject to foreign exchange regulations.

To facilitate the payment of local administrative expenses such as rent and salaries, an IFSC Banking Unit maintains a special Rupee account through an Authorized Dealer. While the unit's primary balance sheet remains in foreign currency, this specific account allows for legal transactions in Indian Rupees. This mechanism ensures compliance with domestic legal tender laws while preserving the unit's offshore status.

- 35.** (A) P-2, Q-3, R-4, S-1

GIFT City offers diverse business opportunities across various segments. Wholesale banking involves activities like equipment leasing and credit enhancement. The capital markets segment focuses on funding alternative investment funds and providing custodial services. Retail banking includes wealth management and structured deposits for individuals. Finally, treasury management allows for the consolidation of group-wise derivative trading, including Non-Deliverable Forwards in the Indian Rupee.

- 36.** (D) The FPI will enjoy a complete waiver of the short term capital gains tax on the derivatives trade.

Foreign Portfolio Investors trading on IFSC exchanges enjoy significant tax benefits designed to boost the center's attractiveness. Specifically, these investors receive a complete waiver of the short-term capital gains tax on derivative trades. This exemption, combined with the lack of securities transaction taxes, makes GIFT City a highly cost-effective environment for high-volume traders compared to the standard domestic Indian market.

- 37.** (A) P-2, Q-3, R-1, S-4

Different entities and accounts serve specific roles in international finance. A Wholly Owned Subsidiary is an entity where the Indian party invests the entire equity. Escrow accounts are established for specific purposes under tripartite agreements. Special Non-Resident Rupee accounts are funded solely by international

foreign currency remittances. Joint Ventures involve shared equity between Indian parties and overseas entities for collaborative business operations.

- 38.** (C) The IBU must maintain a daily retail deposit reserve ratio of 3% (USD 300,000) of these deposits.

IFSC Banking Units that raise deposits from individuals are subject to a specific liquidity requirement known as the retail deposit reserve ratio. For an outstanding amount of ten million US dollars, the unit must maintain a daily reserve of three percent, which equals three hundred thousand US dollars. This mandatory reserve helps ensure that the unit maintains sufficient liquidity to meet individual depositor obligations.

- 39.** (A) Liabilities of the IBU : Exempt from both CRR and SLR requirements of RBI

The regulatory framework for IFSC Banking Units provides several exemptions to ensure their global competitiveness. A key feature is that the liabilities of these units are exempt from the standard Cash Reserve Ratio and Statutory Liquidity Ratio requirements of the RBI. In contrast, the retail deposit reserve ratio is three percent daily, and the minimum capital requirement is twenty million US dollars.

- 40.** (A) The IBU must obtain prior approval from the regulator (RBI/IFSCA) for offering derivative products.

Before offering complex foreign exchange derivative products to institutional clients, an IFSC Banking Unit must obtain prior approval from the appropriate regulator, either the RBI or the IFSCA. This ensures that the unit has the necessary risk management frameworks in place to handle sophisticated financial instruments. This regulatory oversight is vital for maintaining market stability and protecting participants within the IFSC.

- 41.** (A) FPIs at GIFT City : Pay 30% short term capital gains tax on derivatives

The statement regarding Foreign Portfolio Investors paying thirty percent short-term capital gains tax on derivatives at GIFT City is incorrect. In reality, these investors are granted a complete exemption from such taxes to promote liquidity and trading volume. Other features, like

governed by the provisions of the Foreign Exchange Management Act of 1999. This ensures that such transactions do not adversely affect the country's foreign exchange reserves or violate capital account regulations. Compliance with FEMA is mandatory for all cross-border and domestic investments involving foreign currency within the IFSC.

76. (A) P-2, Q-4, R-1, S-3

The IFSCA consolidated regulatory powers from several domestic bodies. SEBI was responsible for securities and exchange regulation, while PFRDA managed pension funds. IRDAI oversaw the insurance sector, and the RBI acted as the central bank and monetary regulator. By unifying these domains under a single authority, the IFSCA has created a more cohesive and efficient regulatory framework for all IFSC businesses.

77. (B) No, obtaining a No Objection letter from the home country regulator is a mandatory condition for the parent bank.

Obtaining a No Objection Certificate from the home country regulator is a mandatory condition for any parent bank wishing to set up an IFSC Banking Unit. Even an expanded Letter of Comfort cannot replace this requirement. Therefore, the IFSCA will not grant a license until the foreign bank produces the necessary NOC, ensuring that the home regulator is aware of the expansion.

78. (A) P-4, Q-3, R-1, S-2

Regulatory limits for IFSC Banking Units are precisely defined to ensure stability. The retail deposit reserve ratio is three percent of individual deposits outstanding daily. Exposure ceilings are set at five percent for single borrowers and ten percent for borrower groups based on parent Tier One Capital. Finally, the parent bank must provide a minimum capital infusion of twenty million US dollars.

79. (D) Exchanges operate 22 hours a day and FPIs are permitted to operate without any additional documentation.

The operational framework at GIFT City is designed to accommodate global investors by allowing exchanges to operate for twenty-two hours a day. This extensive trading window makes the center highly suitable for strategies that rely

on real-time news across multiple time zones. Furthermore, Foreign Portfolio Investors can operate without additional documentation, which significantly streamlines their participation and enhances overall market liquidity.

80. (D) SNRR accounts : Funded strictly by foreign currency remittances through international channels.

Among the permissible activities, Special Non-Resident Rupee accounts must be funded strictly by foreign currency remittances through international channels. This ensures that the Rupee accounts within the IFSC remain connected to offshore funding sources. Other features such as the availability of cheque facilities or the exclusive use of Indian Rupees for transactions are incorrect, as they do not align with IBU regulations.

www.nodia.in

2. USD 12.4 billion
3. 9 %
4. USD 22 Billion

- (A) P-4, Q-2, R-1, S-3
- (B) P-2, Q-4, R-3, S-1
- (C) P-4, Q-1, R-2, S-3
- (D) P-1, Q-2, R-4, S-3

Oct/Nov 2020

28. Evaluate the following statements regarding Blockchain Technology from an infrastructure perspective:

- I. The system will verify data using invoices on the GST System and e-Way bills to quicken transactions.
- II. It aims to eliminate paper work, reduce transaction time, and provide a secure environment.
- III. It involves the total elimination of network connectivity between Banks and clients to ensure absolute isolation.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2016

29. Identify the correct statement regarding the landscape of FINTECH companies in India as of August 2020:

- (A) Companies into digital payments — 14%
- (B) Companies into lending — 17%
- (C) Companies into wealth management — 17%
- (D) Companies established in the last 5 years — 45%

Oct/Nov 2013

30. Examine the following thoughts on upgrading a bank's digital re-engineering plans:

- I. Becoming pro-active and agile to customer responses and market requests.
- II. Self-assessment and driving teamwork to react to changing market conditions.
- III. Organization readiness to re-assigning, re-training, and recruiting additional resources.
- IV. Solely following a predefined static plan without monitoring progress.

Which of the above statement(s) is/are correct?

- (A) I, II, and III

- (B) II, III, and IV
- (C) I, II, and IV
- (D) I, III, and IV

May/June 2017

31. Evaluate the following statements regarding India's position in the global FINTECH space:

- I. India has the highest FINTECH adoption rate globally.
- II. India is the second largest FINTECH hub after the USA.
- III. Fintechs in India are projected to grow to USD 133 Billion by 2023.

Which of the above statements are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2005

32. Examine the following challenges of a manual Documentary Credit (LC) process prior to blockchain technology:

- I. Manual contract creation and confirmation via SWIFT.
- II. Real-time transparent factoring across a decentralized network.
- III. Multiple platforms causing miscommunication and high potential for fraud.
- IV. Significant version control challenges due to multiple versions of documents.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

May/June 2015

33. Identify the correct statement regarding Robotic Process Automation (RPA) in financial institutions.

- (A) RPA refers to the use of complex mathematical algorithms to extract investment behavior for predictive analysis.
- (B) RPA involves assigning manual repetitive tasks to robots instead of humans to streamline workflows.
- (C) RPA is exclusively used for fixing threshold limits to detect fraudulent transactions in real-time.
- (D) RPA connects groups of people and

- (A) Automated Loan Processing Machines
- (B) Advanced Ledger Posting Machines
- (C) Automated Liquidity Pricing Machines
- (D) Advanced Lending and Payment Machines

Oct/Nov 2024

8. Consider the following applications of Blockchain technology:
- I. Centralized KYC
 - II. Cross border payments
 - III. Syndication of loans
 - IV. Trade Finance
 - V. Capital markets
- Which combination represents inter-bank usage of Blockchain technology?
- (A) I, II, III, and V
 - (B) II, III, IV, and V
 - (C) I, III, IV, and V
 - (D) I, II, III, IV, and V

May/June 2013

9. Which of the following is NOT classified as a limitation of technology in International Banking?
- (A) Reduced transaction costs
 - (B) Creating awareness amongst customers because of widespread reach
 - (C) Security issues and cybercrime
 - (D) Control limits for withdrawal and deposits posing inconveniences

Oct/Nov 2011

10. A consortium of financial service providers sets up innovation labs to conduct Proof of Concepts (PoC) for industry-wide blockchain adoption. Which of the following is identified as a priority area for these PoCs?
- (A) Managing conventional fixed deposits
 - (B) Person to Person Payments
 - (C) Issuing traditional paper cheque books
 - (D) Printing physical currency notes

May/June 2010

11. Read the following statements regarding Inward Remittances Online:
- I. It allows online money transfer from any overseas bank in FATF compliant countries to any bank account in India.
 - II. NRIs register on the Internet Banking Platform of their bank to get a log-in ID and password.
 - III. Many banks only allow savings account

transactions and strictly restrict current account transactions for inward remittances. Which of the statements provided above is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2015

12. Evaluate the following challenges in the FINTECH space:
- I. Doubts from financial regulators regarding operations.
 - II. Threat of hacking resulting in data security issues.
 - III. Very low start-up costs encouraging unsustainable market entry.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2006

13. Identify the incorrect pair regarding the usage of Artificial Intelligence in the banking space:
- (A) Sourcing business better — Managing global value chains and complex cross-border cash flows
 - (B) Credit Scoring — Automating repetitive tasks to streamline internal banking workflows
 - (C) Fraud detection — Fixing threshold limits and working in tandem with regulatory entities
 - (D) Identifying customers better — Prospecting, sourcing, and onboarding of importers and exporters

Oct/Nov 2008

14. What does the term “REGTECH” refer to?
- (A) A financial innovation connecting borrowers with investors looking for higher returns.
 - (B) The process of assigning repetitive manual tasks to software robots.
 - (C) Technology in regulatory aspects focusing on the automation of compliance processes for Banks.
 - (D) An entire bank squeezed to fit into a smartphone.

immutable data reducing fraudulent transactions.

Oct/Nov 2015

52. A resident individual wants to utilize a fast and convenient way to transfer money directly to a family member abroad for maintenance. Which digital platform best facilitates this transaction subject to Schedule III permissible limits of FEMA?
- (A) Trade Finance Portal
(B) Inward Remittances Online
(C) Foreign Exchange Rate Portal
(D) Outward Remittances Online

May/June 2006

53. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options provided.
- Assertion (A): In the FINTECH space, the human interface can be completely done away with immediately.
- Reason (R): Direct interface might come down over time, but complete elimination of human interface remains a challenge.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2011

54. Which of the following is the most appropriate reason why banks utilize the World Check List during online outward remittances?
- (A) Evaluating the credit worthiness of the beneficiary for future potential loan syndication.
(B) Determining the real-time spot and forward contract exchange rates for specific currencies.
(C) Scrubbing remitters and beneficiaries to ensure compliance with international sanctions.
(D) Automatically generating the outward remittance message (ORM) for mandatory import payments.

May/June 2011

55. Match the technological terms in List I with their correct definitions in List II.

List I: (Technological Terms)

- P. Digi Bank
Q. Regulatory sandbox
R. Cloud computing
S. Data breach

List II: (Definitions)

1. Delivery of computing services—including servers, storage, and software—over the Internet.
 2. A security incident granting unauthorized access to confidential or sensitive information.
 3. An entire bank squeezed to fit into a smartphone.
 4. An environment allowing field tests to collect evidence on new financial products' risks and benefits.
- (A) P-3, Q-4, R-1, S-2
(B) P-4, Q-3, R-2, S-1
(C) P-3, Q-1, R-4, S-2
(D) P-1, Q-2, R-3, S-4

Oct/Nov 2006

56. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options provided.
- Assertion (A): Banks insist on executing a one-time Indemnity agreement when on-boarding a corporate to the Foreign Exchange Rate Portal.
- Reason (R): The indemnity agreement protects the bank from losses arising out of non-compliance if the corporate fails to submit underlying documents after confirming a deal.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2023

57. An individual is seeking an unsecured personal loan but avoids traditional banking intermediaries. Instead, they use a financial innovation that connects them directly with investors looking to earn a higher return on

through the portal.

May/June 2005

21. Examine the following statements regarding the Import Data Processing and Monitoring System (IDPMS):
- AD Bank generates an Outward Remittance Message (ORM) as per the message format “BoE Settlement”.
 - For non-EDI ports, AD Banks upload the BoE data in IDPMS as per message format “Manual BoE reporting” daily.
 - IDPMS does not facilitate reporting of transactions relating to the Import of services.
 - Multiple BoE can be settled against one Outward remittance.
 - It was operationalized exclusively for reporting advance remittances related to exports.
- Which of the above statements are correct?
- I, II, III, and IV
 - I, II, IV, and V
 - II, III, IV, and V
 - I, III, IV, and V

Oct/Nov 2021

22. Which of the following is NOT listed as a benefit of Inward Remittances Online?
- Fixed and fair exchange rates
 - 24/7 customer support
 - Scrubbing outward remittance against World Check List
 - Quick and seamless transfers from any FATF compliant country

May/June 2012

23. When was the Single Master Form (SMF) window provided to the public (investees) to update investments received under the Foreign Investments route?
- March 1, 2014 to April 1, 2014
 - October 16, 2017 to November 16, 2017
 - June 28, 2018 to July 20, 2018
 - September 1, 2018 to October 1, 2018

Oct/Nov 2025

24. In the context of inter-bank usage of blockchain, what is the most appropriate function of “Smart contracts” during cross border payments?
- Eliminating operational errors by capturing obligations among institutions to ensure

funds exchange.

- Simulating human intelligence to prospect overseas buyers for specific export products.
- Serving as manual invoices factoring documents between traditional correspondent bank branches.
- Replacing the World Check List for AML compliance entirely without providing regulator visibility.

May/June 2023

25. What does FINTECH refer to in the context of modern financial services?
- The synergy between finance and technology that digitizes financial services and automates banking processes.
 - A purely manual mechanism used for issuing e-BRCs.
 - A hardware system exclusively designed to calculate foreign exchange fluctuations in a closed network.
 - A regulatory framework initiated by the government to limit overseas investments.

Oct/Nov 2007

26. Identify the correct pair regarding the evolution of FINTECH versions:
- FINTECH Version 1.0 — Introduction of ATM machine by Barclays
 - FINTECH Version 3.0 — Emerging post-2008 as a result of the financial crisis where people distrusted traditional banking.
 - FINTECH Version 2.0 — First transatlantic cable laid between New York and London
 - FINTECH Version 3.5 — Led by European countries focusing entirely on regulatory compliances

May/June 2008

27. Match the Global FINTECH investment facts in List I with their respective figures/details in List II.

List I: (Global FINTECH Investment Facts)

- Global investments in FINTECH increased in 2015 to more than.
- FINTECH companies in USA raised in 2018.
- Monetary Authority of Singapore pledged to spend in FINTECH over 5 years.
- Sydney’s contribution to its country’s GDP through FINTECH.

List II: (Figures/Details)

- USD 225 Mn

May/June 2014

15. Which combination of features correctly describes the capabilities of the Trade Finance Portal for corporate customers?
- Templated transactions in compliance with international trade provisions.
 - Role-based dashboards offering overviews of pending actionable items like IDPMS and EDPMS.
 - Real-time rate quotation basis directly interacting with the bank's dealing room.
 - Approval of transactions through a maker-checker facility.
- Which of the above statements are correct?
- I, II, and IV
 - I, II, and III
 - II, III, and IV
 - I, III, and IV

Oct/Nov 2019

16. Identify the correct statement that defines "Machine Learning" in the context of banking technologies.
- Simulation of human intelligence processes by physical robots moving physical documents for processing.
 - An environment where regulators test the impact of conventional banking hours on local economies.
 - Automated issuance of shipping bills from the Customs department to the EDPMS for record keeping.
 - Algorithms analyzing millions of data sets to provide inputs on customer transactions and behavior.

May/June 2011

17. Evaluate the following statements concerning the Import Data Processing and Monitoring System (IDPMS):
- AD Banks download the Bill of Entry (BoE) issued by EDI Ports from the BoE Master in the IDPMS based on the AD Code declared by the importer.
 - Multiple outward remittances cannot be settled against a single BoE under any circumstances.
- Which of the statements provided above is/are correct?
- Only I
 - Only II
 - Both I and II

(D) Neither I nor II

Oct/Nov 2018

18. What is the fundamental difference between Data Privacy and a Data Breach?
- Data Privacy is an external attack, whereas a Data Breach is an internal mechanism to safeguard information.
 - Data Privacy involves hardware encryption, whereas a Data Breach involves software corruption.
 - Protecting individual information created via the internet versus a security incident involving unauthorized data access.
 - Data Privacy is managed exclusively by regulators, whereas a Data Breach is orchestrated exclusively by the bank.

May/June 2019

19. Identify the incorrect statement regarding the handling of service imports within the IDPMS platform.
- The IDPMS platform facilitates automated reporting of transactions and remittances relating to the Import of services.
 - The AD Bank generates an Outward Remittance Message (ORM) for import payment made by its importer.
 - IDPMS was developed in consultation with customs authorities to enhance the ease of doing business.
 - For services, the AD Bank must follow up with the importer until the remittance towards the requisitioned service imports is completed.

Oct/Nov 2012

20. Identify the incorrect statement regarding the Foreign Exchange Rate Portal.
- It is provided to corporates who meet the bank's criteria and log in via the Internet Banking Platform.
 - Corporates are permitted to access the dealing room on a real-time basis to book cash, tom, spot, and forward contracts.
 - Non-compliance regarding document submission results in the deal being automatically cancelled, with losses recovered from the corporate.
 - Corporates are exempt from regulatory guidelines regarding the submission of underlying documents if they book deals

processes in a decentralized ledger to create an audit trail.

Oct/Nov 2016

34. Evaluate the following steps in the process flow of a documentary credit using blockchain technology:
- I. Upon purchase, the agreement of sale is shared with the Importer Bank using a smart contract.
 - II. Exporter digitally signs a blockchain equivalent LC within the smart contract to initiate shipment.
 - III. Goods are inspected by 3rd parties and Customs Authorities who provide digital signatures of approval.
 - IV. During transit, goods are transported using manual ledgers only to prevent digital hacking.
 - V. Upon delivery, the importer digitally acknowledges receipt of goods and triggers payment.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V
 - (B) I, II, IV, and V
 - (C) II, III, IV, and V
 - (D) I, III, IV, and V

May/June 2020

35. Match the technological applications in List I to the delivery channels in List II.
- List I: (Technological Applications)
- P. Analyzing economic trajectories of partners during trade negotiations.
 - Q. Developing predictive analysis on consumer spending habits.
 - R. Communication and marketing through emails and chatbots.
 - S. Transparent factoring and decentralized contract execution.
- List II: (Delivery Channels)
1. Big Data & Data Analytics
 2. Blockchain Technology
 3. Artificial Intelligence
 4. Robotic Process Automation
- (A) P-3, Q-1, R-4, S-2
 - (B) P-1, Q-3, R-2, S-4
 - (C) P-4, Q-2, R-1, S-3
 - (D) P-3, Q-4, R-1, S-2

Oct/Nov 2010

36. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options provided.
- Assertion (A): High start-up costs act as a significant challenge in the FINTECH space.
- Reason (R): Data security and the threat of hacking require substantial investment to protect sensitive financial data of customers and countries.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2024

37. How is "Predictive analysis" defined in the context of data analytics in banking?
- (A) Machine-based simulation of human intelligence for automated loan approvals.
 - (B) Implementation of advanced security protocols for outward remittance encryption.
 - (C) Tracking of shipping bills using a decentralized and immutable digital ledger.
 - (D) Predicting consumer behavior using past information and mathematical algorithms.

Oct/Nov 2017

38. A bank seeks to improve its process of onboarding importers and exporters involved in international trade. The bank decides to deploy technology that can automatically analyze massive datasets to prospect and source these customers efficiently. Which technology is best suited for this scenario?
- (A) Predictive Analysis using Big Data
 - (B) Robotic Process Automation
 - (C) Artificial Intelligence
 - (D) Blockchain Smart Contracts

May/June 2009

39. What is the fundamental concept underlying Blockchain Management?
- (A) A centralized database controlled by a single trusted intermediary used to store and verify various regulatory records.
 - (B) An encrypted digital ledger of transactions

distributed across a network, ensuring high resistance to unauthorized changes.

- (C) A software robot used to automate email communication, customer interactions, and basic statistical data collection tasks.
- (D) An algorithmic model that mimics human logic and physical actions to predict future foreign currency fluctuations.

Oct/Nov 2022

40. A financial institution decides to train its human resources in distributed ledger technologies and enable efficient asset management internally before launching customer-facing blockchain applications. Which phase of adoption does this scenario represent?
- (A) Intra-bank usage of Blockchain technology
 - (B) Inter-bank usage for Cross border payments
 - (C) Inter-bank usage for Centralized KYC
 - (D) Blockchain integration with GST systems

May/June 2022

41. Identify the incorrect statement comparing manual LC processes to Blockchain-based LC processes.
- (A) In a manual process, duplicate Bills of Lading (BLs) are impossible because intermediary checks ensure strict version control.
 - (B) In blockchain, the agreement of sale is shared with the Importer Bank using a smart contract on the blockchain.
 - (C) In a manual process, the exporter's bank must manually conduct AML checks using the financials provided by the Import Bank.
 - (D) In blockchain, the exporter digitally signs a blockchain equivalent LC within the smart contract to initiate shipment.

Oct/Nov 2009

42. What defines the alignment of IT architecture in the transformation of an operating model for a digital bank?
- (A) Identifying existing business and IT capabilities to evaluate the current digital maturity and operational readiness of the bank.
 - (B) Re-engineering traditional engagement systems alongside digital enablers in front-office, back-office, and operational systems.
 - (C) Setting a specific goal and mission to identify the target business model required

for comprehensive digital reinvention.

- (D) Determining a bank's budget plan, risk appetite, and resource allocation through a strategic decision-making roadmap.

May/June 2018

43. Examine the following features related to Blockchain Technology:
- I. Real time review
 - II. Transparent factoring
 - III. Disintermediation
 - IV. Reduced counterparty risk
- Which combination represents the advantages of using Blockchain Technology in International Trade Finance?
- (A) I, II, and III only
 - (B) I, III, and IV only
 - (C) II, III, and IV only
 - (D) I, II, III, and IV

Oct/Nov 2012

44. A large commercial bank wants to upgrade its digital re-engineering plans to stay competitive. The management team seeks to make the bank more relevant to customers while adopting an agile approach. Which of the following is an appropriate strategic thought for upgrading the digital re-engineering plans?
- (A) Focusing exclusively on recruiting external talent rather than evaluating the relative benefits of speed vis-à-vis in-house talent.
 - (B) Implementing a rigid plan to react to changing market conditions without relying on self-assessment.
 - (C) Developing digital ecosystems and platforms that deliver traditional and non-traditional products to customers.
 - (D) Outsourcing the entire process re-engineering to third-party providers without assessing organizational readiness.

May/June 2016

45. Evaluate the following statements about the Indian Block Chain Infrastructure Co. Pvt Ltd:
- I. It is a company formed by 15 Schedule Commercial Banks in June 2021.
 - II. Each of the participating banks holds an identical stake of 6.66% in the company.
- Which of the statements provided above is/are correct?
- (A) Only I
 - (B) Only II

- (C) Both I and II
(D) Neither I nor II

Oct/Nov 2007

46. Arrange the following technological developments in the financial sector in the correct chronological order of their evolution:
- I. Introduction of the first ATM machine by Barclays.
 - II. Establishment of the first transatlantic cable.
 - III. Introduction of Bitcoin and other cryptocurrencies.
 - IV. FEDWIRE, the first electronic funds transfer via telegraph and Morse Code.
- (A) II, IV, I, III
(B) II, I, IV, III
(C) IV, II, I, III
(D) I, II, IV, III

May/June 2008

47. During a phased adoption of Blockchain Technology by a banking system, a bank creates a private blockchain to train its human resources and enable efficient asset management internally before launching customer-facing blockchain applications. Which phase does this describe?
- (A) Inter-bank usage for Cross border payments
(B) Inter-bank usage for Centralized KYC
(C) Inter-bank usage for Syndication of loans
(D) Intra-bank usage of Blockchain technology

Oct/Nov 2018

48. Which of the following is NOT a benefit of technology in International Banking?
- (A) Ease of doing business
(B) Reduction in manpower
(C) Enhanced management information systems
(D) Elimination of all regulatory requirements

May/June 2022

49. Match the Inter-bank usage applications of Blockchain in List I with their corresponding advantages in List II.
- List I: (Inter-bank usage applications of Blockchain)
- P. Centralized KYC
Q. Cross border payments
R. Syndication of loans
S. Capital markets

List II: (Advantages)

1. Reduces liquidity and operational costs while enabling real-time settlement via smart contracts.
 2. Automates underwriting activities leveraging financial details stored on a distributed ledger.
 3. Streamlines back-office functions and shortens settlement times by reducing trade errors.
 4. Reduces duplicative efforts in customer onboarding through shared secure databases.
- (A) P-4, Q-1, R-2, S-3
(B) P-1, Q-4, R-3, S-2
(C) P-4, Q-2, R-1, S-3
(D) P-2, Q-3, R-4, S-1

Oct/Nov 2014

50. Identify the correct statement regarding the Export Data Processing and Monitoring System (EDPMS).
- (A) EDPMS fully supports and facilitates the reporting of export transactions relating to Service Exports.
(B) Issuance of e-BRC was introduced on 16th Oct 2017 to facilitate AD Banks to issue e-BRC independently of the data available in the EDPMS.
(C) EDPMS was operationalized by the Reserve Bank of India on March 1, 2014, for reporting lodgment and realization of export declarations.
(D) System-based caution listing applies to exporters whose EDF/SB/SOFTEX are outstanding beyond 1 year.

May/June 2005

51. Identify the incorrect pair regarding the transition from manual to blockchain environments:
- (A) Manual process — Real-time review of draft terms of credit and immediate submission of obligation to pay to the export bank.
(B) Blockchain process — Goods inspected by 3rd parties and Customs Authorities providing digital signatures of approval on the smart contract.
(C) Manual process — Multiple versions of documents causing significant version control challenges.
(D) Blockchain process — Transparent and

CHAPTER 10

Technology in International Banking

May/June 2018

1. A financial services provider, in collaboration with regulators, wishes to conduct a field test to collect evidence on the benefits and risks of a newly developed digital lending product before launching it publicly. Which framework provides the required environment for this activity?
(A) EDPMS
(B) Regulatory Sandbox
(C) IDPMS
(D) Digi Bank

Oct/Nov 2023

2. An importer and exporter have agreed on a purchase. Using blockchain technology, which mechanism is immediately utilized to share the agreement of sale with the Importer Bank?
(A) A physical SWIFT MT 700 message
(B) An advanced ledger posting machine (ALPM)
(C) A smart contract on the blockchain
(D) The Export Data Processing and Monitoring System (EDPMS)

May/June 2007

3. Which concept involves refining very large, diverse data sets that include structured, semi-structured, and raw data to extract consumer preferences, spending habits, and investment behavior?
(A) Big Data and Data Analytics
(B) Robotic Process Automation
(C) Artificial Intelligence
(D) Cloud Computing

Oct/Nov 2014

4. Which of the following is considered an advantage rather than a challenge in using Blockchain Technology in Cross Border Transactions?
(A) Addressing complex regulatory and compliance issues within the local framework.
(B) Introducing an additional data layer along

the payment process for stakeholders.

- (C) Monitoring the routing of transactions through high-risk countries for audit.
- (D) Granting regulators a real-time view of essential documents to assist enforcement.

May/June 2021

5. Evaluate the following statements regarding the evolution of technology in International Banking:
 - I. The pre-nationalization period involved mostly manual banking activities because the country's population was primarily illiterate.
 - II. The second phase of nationalization in 1980 brought an additional 14 banks into the fold of Government ownership.Which of the statements provided above is/are correct?
(A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

Oct/Nov 2006

6. What is the most appropriate definition of "Disintermediation" as an advantage of blockchain technology in trade finance?
(A) The tracking of Bills of Lading across the supply chain to eliminate instances of double spending.
(B) The execution of contracts in real-time to monitor the physical delivery of goods and services.
(C) Facilitating trade finance without a trusted intermediary, thereby removing the need for correspondent banks.
(D) The reduction of transaction fees by centralizing authority in a single node within a private network.

May/June 2025

7. What was the primary function of ALPMs introduced in the banking sector in the 1980s?

their investments. Which term best describes this innovation?

- (A) P2P Lending
- (B) Cloud Computing
- (C) Trade Finance Portal
- (D) Syndication of loans

Oct/Nov 2021

58. On which date was the single revised FC-GPR (Foreign Currency – Gross Provisional Returns) introduced with the implementation of the Single Master Form (SMF)?
- (A) June 28, 2018
 - (B) July 20, 2018
 - (C) September 1, 2018
 - (D) October 16, 2017

May/June 2015

59. Identify the correct statement regarding a bank's digital re-engineering roadmap.
- (A) Defining the target architecture, operating model, resources, risk appetite, timelines, and costs.
 - (B) Assessing the existing digital maturity and gaps is irrelevant to overall digital capability.
 - (C) The roadmap is finalized without needing to define the bank's budget plan or resources.
 - (D) IT architecture alignment focuses solely on traditional systems of engagement, ignoring modern digital enablers.

Oct/Nov 2008

60. A bank's trade finance division is trying to update its records for an exporter who recently realized export proceeds. The exporter is demanding an e-BRC to claim certain trade benefits. What is the mandatory platform the bank must update on an "as and when realized basis" before issuing the e-BRC?
- (A) IDPMS
 - (B) FIRMS Portal
 - (C) EDPMS
 - (D) Trade Finance Portal

May/June 2014

61. Identify the incorrect statement regarding the handling of Bill of Entry (BoE) in IDPMS.
- (A) Multiple outward remittances can be settled against a single BoE.
 - (B) AD banks are prohibited from settling more than one Bill of Entry against a single Outward Remittance message.

- (C) Multiple BoE can be settled against one Outward remittance.
- (D) The AD Bank generates an ORM as per the "BoE Settlement" message format.

Oct/Nov 2013

62. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options provided.
- Assertion (A): Data analytics can be effectively utilized to create new portfolios in International Trade by using historical data.
- Reason (R): Analyzing past trends helps to explore opportunities with countries having robust infrastructure development and political stability.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2021

63. What is the most appropriate objective behind the introduction of the Single Master Form (SMF) via the FIRMS portal?
- (A) Issuing duplicate e-BRCs automatically through a centralized and automated banking software.
 - (B) Acting as a regulatory sandbox for testing new lending products for the general public.
 - (C) Tracking the shipment of goods manually across multiple customs points for better auditing.
 - (D) Integrating various foreign investment reporting types into a consolidated mechanism.

Oct/Nov 2019

64. Match the FINTECH milestones in List I with their corresponding years in List II.
- List I: (FINTECH Milestones)
- P. Introduction of FINTECH Version 3.0 due to the global financial crisis.
 - Q. Bitcoin introduced followed by other cryptocurrencies.
 - R. First electronic funds transfer via FEDWIRE.
 - S. First digital stock exchange and

without the need for manual processing of traditional paper documents.

- 25. (A)** The synergy between finance and technology that digitizes financial services and automates banking processes.

Financial technology represents the integration of digital tools with financial services to improve efficiency and delivery. It encompasses a wide range of innovations that automate traditional banking tasks, from mobile payments to algorithmic trading. This movement focuses on using technology to create more accessible, faster, and more cost-effective financial solutions for consumers and businesses, moving away from manual methods.

- 26. (B)** FINTECH Version 3.0 — Emerging post-2008 as a result of the financial crisis where people distrusted traditional banking.

The third wave of financial technology development arose following the 2008 global financial crisis, driven by a decline in public trust toward conventional banks. This era saw the rise of startups offering alternative digital services outside the traditional banking infrastructure. Earlier versions focused on infrastructure like cables or the introduction of the first ATMs, which occurred well before this period.

- 27. (A)** P-4, Q-2, R-1, S-3

Global investment in financial technology reached significant milestones, with total funding exceeding twenty-two billion dollars by 2015. Companies in the United States alone raised over twelve billion dollars in 2018. Regional hubs like Singapore and Sydney also saw major commitments, with Singapore pledging two hundred and twenty-five million dollars and Sydney contributing nine percent to its national economy.

- 28. (A)** I and II only

Modern financial infrastructure aims to improve efficiency by integrating with tax and transport systems to verify trade data quickly. These systems focus on reducing the reliance on physical paperwork and shortening the time required for transactions within a secure digital environment. Absolute isolation is not the goal; rather, secure and seamless connectivity between institutions is essential for functional operations.

- 29. (B)** Companies into lending — 17%

As of late 2020, the landscape for financial technology in India showed a diverse range of companies across various sectors. Lending firms represented approximately seventeen percent of the industry, highlighting the growth of digital credit solutions. This sector, alongside payments and wealth management, forms a core part of the ecosystem, which has seen a massive surge in startups recently.

- 30. (A)** I, II, and III

Successful digital transformation requires a bank to be proactive and responsive to market changes while fostering strong internal teamwork. It involves assessing current capabilities and being prepared to retrain or recruit staff to meet new technological demands. Relying on a static, unmonitored plan is counterproductive, as the digital landscape requires constant evaluation and adjustment to remain relevant and competitive.

- 31. (D)** I, II, and III

India has established itself as a global leader in financial technology adoption, boasting the highest rate worldwide. It currently ranks as the second-largest hub for these companies, following only the United States. The sector is projected to reach significant valuation milestones by 2023, reflecting a robust ecosystem supported by digital payments, lending innovations, and favorable regulatory environments.

- 32. (C)** I, III, and IV

Traditional documentary credit processes suffer from high levels of manual intervention, involving paper-based contracts and multiple communication platforms. These factors often lead to miscommunication and increase the risk of fraudulent activities. Managing different versions of physical documents also presents significant control challenges. In contrast, decentralized networks provide real-time transparency, which is a feature of modern technology rather than a manual drawback.

- 33. (B)** RPA involves assigning manual repetitive tasks to robots instead of humans to streamline workflows.

Robotic process automation focuses on using software tools to perform high-volume, routine tasks that were previously handled by people. By

mathematical algorithms.

IV. Communication and marketing through emails and chatbots.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

Oct/Nov 2010

72. What is the fundamental concept behind Big Data in the banking space?

- (A) The use of advanced analytic techniques against very large, diverse sets of structured, semi-structured, and raw data.
- (B) The simulation of human intelligence processes by machines to underwrite loans.
- (C) A system of recording information in an immutable digital ledger distributed across a network.
- (D) The delivery of computing services over the internet to offer flexible resources.

May/June 2009

73. Evaluate the following evolutionary milestones in banking technology up to the year 2008:

- I. 1866: First transatlantic cable laid.
- II. 1918: FEDWIRE introduced.
- III. 1950: Diners Club and Amex Cards.
- IV. 1967: First digital stock exchange and SWIFT established.
- V. 2008: FINTECH Version 3.0 brought in due to the global financial crisis.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) II, III, IV, and V only
- (C) I, III, IV, and V only
- (D) I, II, III, IV, and V

Oct/Nov 2017

74. A commercial bank has massive volumes of historical international transaction records and wishes to develop predictive models indicating how consumers are likely to behave. Which application area relies on mathematical algorithms and past information to achieve this?

- (A) Transaction management using RPA
- (B) Predictive analysis using Big Data
- (C) Decentralized contract execution using Blockchain
- (D) Regulatory compliance management using REGTECH

May/June 2025

75. Examine the following elements regarding the characteristics and scope of FINTECH:

- I. It refers to the synergy between finance and technology.
- II. It disrupts traditional financial processes to make them more efficient.
- III. It exclusively provides services to credit unions and investment banking, ignoring traditional banking.
- IV. It utilizes chat bots, mobile applications, and machine learning.
- V. It can lead to new business models or new businesses.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) I, II, IV, and V
- (C) I, III, IV, and V
- (D) II, III, IV, and V

Oct/Nov 2018

76. Which of the following is NOT an application area of Robotic Process Automation (RPA)?

- (A) Automated statistics and data collection from multiple sources.
- (B) Managing complex regulatory compliances across different jurisdictions.
- (C) Transparent factoring of invoices on a distributed digital ledger.
- (D) Streamlining transaction management through automated software robots.

May/June 2019

77. A corporate client wishes to actively book foreign exchange spot and forward contracts online. The bank provides them access to the Foreign Exchange Rate Portal. However, the bank is concerned about potential losses if the client fails to submit the necessary underlying documents after booking the deal. What action must the bank take during the on-boarding process to mitigate this specific risk?

- (A) Implement a Regulatory Sandbox for the corporate.
- (B) Insist the corporate execute a one-time Indemnity agreement.
- (C) Automatically route all transactions to the FIRMS portal.
- (D) Subject the corporate to manual AML review only.

NODIA

Oct/Nov 2012

78. During a manual Documentary Credit (LC) process, an exporter uses a contract and raises requests to achieve short-term financing from multiple banks simultaneously, exploiting the fact that banks cannot verify authenticity instantly. What is this specific risk called?
- (A) Duplicate BLs financing
 - (B) Decentralized contract execution
 - (C) Invoice factoring risk
 - (D) Real-time review mismatch

May/June 2012

79. An exporter shipping goods from Country A to Country B wants complete transparency into the location and title of the goods during transit without relying on intermediary banks to confirm status manually. Which technological advantage ensures the title is available transparently?
- (A) Bulk upload facility on the Trade Finance Portal.
 - (B) Issuance of e-BRC linked to EDPMS.
 - (C) World Check List scrubbing.
 - (D) Proof of ownership provided within the blockchain.

Oct/Nov 2025

80. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options provided.
- Assertion (A): The chances of cyberattacks are relatively low when blockchain technology is employed in International Trade Finance.
- Reason (R): Each transaction in a blockchain is encrypted, and the digital ledger is securely stored and distributed across the network.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

ANSWERS

1. (B) Regulatory Sandbox
A regulatory sandbox provides a live testing environment where financial institutions can trial innovative products under regulatory supervision. This framework allows providers to gather evidence on benefits and risks before a full-scale public launch. It facilitates controlled experimentation while ensuring consumer protection and maintaining the integrity of the financial system through close collaboration with regulators.
2. (C) A smart contract on the blockchain
Digital ledger technology utilizes automated self-executing agreements to share sale details instantly between trading parties and their financial institutions. These automated protocols ensure that once specific conditions are met, the transaction proceeds without manual intervention. This mechanism replaces traditional physical messaging, providing a faster and more transparent way to handle international trade documentation within a decentralized network.
3. (A) Big Data and Data Analytics
Refining massive and diverse datasets involves using advanced analytic techniques to process structured and unstructured information. This process allows financial institutions to uncover meaningful patterns regarding how consumers spend, invest, and manage their preferences. By examining these large volumes of raw data, banks can gain valuable insights to improve their service delivery and develop targeted financial products.
4. (D) Granting regulators a real-time view of essential documents to assist enforcement.
Providing regulatory authorities with immediate access to transaction documents is a significant benefit of distributed ledger technology. This transparency simplifies compliance monitoring and assists in the effective enforcement of international trade laws. Unlike the challenges of navigating complex local regulations or adding extra data layers, this feature enhances visibility across the entire supply chain, making the auditing process more efficient.
5. (A) Only I
During the pre-nationalization era, banking activities were predominantly manual because a significant portion of the population lacked formal literacy. This manual approach was the standard before the government took over major banks to expand reach. While the second phase of nationalization did occur in 1980, it actually involved six additional banks rather than fourteen, making only the first statement accurate.
6. (C) Facilitating trade finance without a trusted intermediary, thereby removing the need for correspondent banks.
Disintermediation in trade finance refers to the removal of traditional middlemen from the transaction process using decentralized technology. By allowing parties to interact directly on a secure ledger, the reliance on correspondent banks for verification and settlement is significantly reduced. This shift lowers costs and speeds up transactions by eliminating the need for central authorities to validate every exchange.
7. (B) Advanced Ledger Posting Machines
Introduced during the 1980s, these machines represented an early step toward automating banking operations by focusing on account maintenance and ledger updates. They were designed to improve the efficiency of recording transactions compared to traditional manual ledger entries. This technological advancement paved the way for more sophisticated computerized systems, marking a transition from purely manual record-keeping in the banking sector.
8. (D) I, II, III, IV, and V
Distributed ledger technology is utilized across multiple inter-bank activities to enhance transparency and efficiency. These applications include managing customer verification data, facilitating cross-border payments, and

establishment of SWIFT.

List II: (Years)

1. 1967
2. 1918
3. 2008
4. 2009

- (A) P-3, Q-4, R-2, S-1
 (B) P-4, Q-3, R-1, S-2
 (C) P-3, Q-1, R-4, S-2
 (D) P-1, Q-2, R-3, S-4

May/June 2007

65. What was the most appropriate reason for AD Banks updating the EDPMS with data of export proceeds on an “as and when realized basis” from October 16, 2017?
- (A) Permitting advance remittances related to the overseas import of specific services.
 (B) Facilitating e-BRC issuance using only the data available within the EDPMS platform.
 (C) Clearing the pending IDPMS discrepancies automatically through an integrated database.
 (D) Initiating the generation of Outward Remittance Messages (ORM) for specific importers.

Oct/Nov 2009

66. Arrange the following technological advancements in the evolution of FINTECH in their correct chronological sequence:
- I. FINTECH Version 3.5 introduced mainly by Asian countries.
 II. First ATM machine introduced by Barclays switching from analogue to digital.
 III. Introduction of Diners Club and Amex Cards.
 IV. Google and Apple Pay introduces payment systems.
- (A) II, III, IV, I
 (B) III, II, IV, I
 (C) III, II, I, IV
 (D) II, IV, III, I

May/June 2010

67. Evaluate the following statements regarding the role of Artificial Intelligence (AI) in international banking:
- I. AI can evaluate the business intelligence of clients by analyzing processing ability and the maturity profile of receivables and payables.

II. AI lacks the capability to conduct credit scoring based on the willingness and ability to repay.

Which of the statements provided above is/are correct?

- (A) Only I
 (B) Only II
 (C) Both I and II
 (D) Neither I nor II

Oct/Nov 2024

68. Which location is identified as the biggest FINTECH center contributing 9% to the country's GDP?
- (A) London
 (B) New York
 (C) Singapore
 (D) Sydney

May/June 2017

69. Evaluate the following statements regarding the advantages of Blockchain in Capital Markets:
- I. It reduces or eliminates trade errors.
 II. It streamlines back-office functions.
 III. It significantly extends and lengthens settlement times to allow for manual review.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 (B) II and III only
 (C) I and III only
 (D) I, II, and III

Oct/Nov 2016

70. A central bank wants to evaluate the economic trajectories of a partner country before executing an international trade agreement. Which specific technology enables problem-solving by simulating human intelligence and analyzing the partner's trajectory under different assumptions?
- (A) Robotic Process Automation
 (B) Cloud Computing
 (C) Artificial Intelligence
 (D) Blockchain Management

May/June 2013

71. Examine the following capabilities of Robotic Process Automation (RPA) in financial institutions:
- I. Statistics and data collection.
 II. Regulatory compliances management.
 III. Predictive analysis of stock markets using

automation or regulatory testing environments, as it focuses on software-driven analysis of information to improve decision-making.

17. (A) Only I

Authorized dealer banks access the import data system to retrieve details of entry documents issued by electronic ports based on the importer's code. This allows for the electronic tracking of imported goods and the corresponding payments. Contrary to restrictive assumptions, the system is flexible enough to allow multiple outward remittances to be settled against a single bill of entry.

18. (C) Protecting individual information created via the internet versus a security incident involving unauthorized data access.

Privacy concerns the measures and rights related to safeguarding personal information generated through digital interactions. In contrast, a data breach occurs when a security failure leads to the unauthorized viewing or theft of sensitive records. While privacy focuses on the control and ethical use of data, a breach is a specific incident where security protocols are bypassed by external or internal actors.

19. (A) The IDPMS platform facilitates automated reporting of transactions and remittances relating to the Import of services.

While the import monitoring system is designed to track physical goods through entry documents, it does not currently provide automated reporting for the import of services. Banks are responsible for generating remittance messages and coordinating with importers to ensure that payments for services are properly documented. The system was developed primarily to enhance transparency and ease of doing business for physical trade.

20. (D) Corporates are exempt from regulatory guidelines regarding the submission of underlying documents if they book deals through the portal. Using a digital platform for foreign exchange does not remove the legal obligation for companies to provide supporting documentation for their transactions. Regulators require that all currency deals be backed by valid underlying trade or financial reasons. Failure to comply with these requirements can lead to the cancellation of

contracts and financial penalties, as these portals must operate within legal frameworks.

21. (A) I, II, III, and IV

Authorized banks use specific message formats to report settlement and manual entry of import data for both electronic and non-electronic ports. While the system manages various physical import tracking tasks, it does not facilitate automated reporting for service-based imports. It allows flexibility in matching multiple entry documents with remittances. The system was designed for import monitoring rather than just export-related advance payments.

22. (C) Scrubbing outward remittance against World Check List

Online inward remittance services offer advantages such as round-the-clock support, competitive exchange rates, and efficient transfers from compliant nations. These features focus on the convenience and speed of receiving money from abroad. Checking transactions against international sanctions lists is a mandatory compliance procedure for outward transfers rather than a specific consumer benefit provided to those receiving inward funds through these platforms.

23. (C) June 28, 2018 to July 20, 2018

A specific timeframe was provided for entities to report and update their foreign investment data through a consolidated reporting platform. This window allowed for the reconciliation of existing investment records before the mandatory implementation of the new master form system. This initiative was part of a broader effort to simplify the reporting of foreign direct investment and ensure data accuracy.

24. (A) Eliminating operational errors by capturing obligations among institutions to ensure funds exchange.

Smart contracts use self-executing code to formalize and automate the obligations between financial institutions during international transfers. By automatically triggering actions once specific conditions are verified on the ledger, these contracts reduce the risk of human error and delays. This ensures that the exchange of funds happens securely and transparently,

organizing loan syndications. Furthermore, the technology is applied to trade finance operations and capital market transactions. Implementing a shared ledger across these diverse areas helps reduce errors, lower costs, and speed up settlement processes between institutions.

9. (A) Reduced transaction costs

Improving efficiency and lowering the expenses associated with financial services are primary benefits of technological integration in banking. These outcomes contrast with the limitations or challenges, such as cybercrime risks, security vulnerabilities, and the need for customer education. While technology can impose certain inconveniences like withdrawal limits, the actual reduction in operational costs is considered a positive advancement rather than a drawback.

10. (B) Person to Person Payments

Innovation labs focusing on industry-wide technology adoption prioritize areas that can demonstrate immediate value through decentralized systems. Person-to-person payments are a key focus for proof-of-concept projects as they benefit from the speed and security of distributed ledgers. These initiatives move away from traditional paper-based methods like cheque books or physical currency, focusing instead on modernizing the way individuals transfer value.

11. (A) I and II only

Online inward remittances enable transfers from banks in compliant jurisdictions to any bank account within the destination country. Users typically register on their bank's internet platform to obtain secure login credentials for managing these transactions. While many banks facilitate these transfers for personal savings, they often extend these services to various account types, including business-related accounts, depending on regulatory guidelines.

12. (A) I and II only

Financial technology providers face significant hurdles, including regulatory skepticism and the constant threat of cyberattacks. Regulators often have concerns about the operational stability and compliance of new digital platforms. Additionally, protecting sensitive user data from hacking is a critical security priority. Unlike high-

barrier industries, low entry costs are generally not considered a primary challenge compared to these systemic risks.

13. (B) Credit Scoring — Automating repetitive tasks to streamline internal banking workflows

In the banking sector, credit scoring involves using sophisticated models to assess the risk of lending by analyzing a borrower's financial history and repayment capacity. Automating repetitive tasks is more accurately associated with robotic process automation rather than the core function of credit scoring. AI functions in banking typically focus on identifying customers, sourcing business opportunities, and detecting fraudulent patterns.

14. (C) Technology in regulatory aspects focusing on the automation of compliance processes for Banks.

Regulatory technology focuses on using software to manage and automate the complex compliance requirements faced by financial institutions. It helps banks stay updated with changing laws and ensures that reporting is accurate and timely. By digitizing these processes, organizations can reduce the risk of human error and lower the operational costs associated with meeting legal and regulatory standards.

15. (A) I, II, and IV

Trade portals for corporate users provide structured templates for international transactions and offer comprehensive dashboards to monitor pending items like data monitoring systems. They also include secure internal controls through maker-checker facilities to ensure accuracy and authorization. While these systems streamline communication, they do not always provide a direct real-time interface with a bank's dealing room for every rate quotation.

16. (D) Algorithms analyzing millions of data sets to provide inputs on customer transactions and behavior.

Machine learning involves using advanced mathematical algorithms to process and learn from vast amounts of data without explicit programming for every task. In financial services, this technology identifies trends in customer behavior and transaction patterns to provide actionable insights. This differs from physical

automating these processes, financial institutions can increase accuracy and speed while allowing human employees to focus on more complex activities. This technology is distinct from advanced data analytics or decentralized ledgers, as its primary goal is operational efficiency.

34. (A) I, II, III, and V

In a blockchain-based credit process, sale agreements are shared via smart contracts and exporters use digital signatures to initiate shipments. Inspections and approvals from authorities are also recorded digitally on the ledger. Once delivery is confirmed, the importer's digital acknowledgement triggers payment. This digital workflow eliminates the need for manual ledgers, which are not used during transit in this system.

35. (A) P-3, Q-1, R-4, S-2

Artificial intelligence is used to simulate human intelligence during trade negotiations, while big data analytics focuses on predicting consumer habits. Software robots handle repetitive communication tasks like chatbots, and blockchain technology provides decentralized contract execution for factoring. Each of these delivery channels serves a distinct purpose in modernizing financial services by applying specialized technology to different operational and analytical needs.

36. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Launching a financial technology venture involves substantial initial expenses, primarily due to the complex infrastructure required for security. Protecting sensitive customer data and preventing cyberattacks necessitates significant investment in advanced encryption and defensive systems. Therefore, the need for robust data security directly contributes to the high startup costs faced by companies entering the digital financial services market.

37. (D) Predicting consumer behavior using past information and mathematical algorithms.

This analytical approach utilizes historical data and complex statistical models to forecast future trends and individual actions. In banking, it helps institutions anticipate how customers will

spend or invest, allowing for more personalized service. It is a data-driven process that focuses on probability and patterns rather than physical automation, immutable ledger tracking, or the simulation of general intelligence.

38. (C) Artificial Intelligence

Artificial intelligence is uniquely capable of processing massive datasets to identify and source potential international trade clients. By simulating cognitive functions, it can evaluate business intelligence and maturity profiles to improve the prospecting and onboarding process. While other technologies like automation or blockchain handle different operational aspects, AI excels at the complex analysis required for customer identification and sourcing.

39. (B) An encrypted digital ledger of transactions distributed across a network, ensuring high resistance to unauthorized changes.

The core of this technology is a decentralized system for recording data that is shared among all participants in a network. Because every transaction is encrypted and verified by the network, the ledger is highly secure and nearly impossible to alter retroactively. This eliminates the need for a single central authority and provides a transparent, immutable record of information.

40. (A) Intra-bank usage of Blockchain technology

The internal phase of technology adoption involves a single institution creating its own private network to test applications and train staff. This allows the bank to manage its own assets and refine processes before expanding to inter-bank or public-facing systems. By focusing on internal efficiency first, the bank can ensure organizational readiness and technical competency in a controlled environment.

41. (A) In a manual process, duplicate Bills of Lading (BLs) are impossible because intermediary checks ensure strict version control.

In a manual process, duplicate Bills of Lading (BLs) are a risk because manual intermediary checks often lack strict version control. One of the primary risks in traditional paper-based trade finance is the possibility of duplicate documents being used to obtain multiple financings for the same shipment. Blockchain solves this by

providing a single, immutable source of truth that tracks ownership and prevents document duplication.

- 42.** (B) Re-engineering traditional engagement systems alongside digital enablers in front-office, back-office, and operational systems. Aligning information technology architecture during a digital transformation involves modernizing both legacy systems and new digital tools. This process ensures that front-end customer interfaces and back-end operational workflows work together seamlessly. It is not just about setting goals or budgeting, but about the technical integration of various platforms to support a comprehensive and efficient digital banking environment.
- 43.** (D) I, II, III, and IV
Implementing distributed ledgers in international trade offers several key benefits, including real-time oversight for regulators and transparent factoring of invoices. The technology enables transactions without traditional intermediaries and significantly lowers the risk of counterparty default through automated verification. These features combined create a more efficient, secure, and cost-effective environment for managing the complex requirements of global finance.
- 44.** (C) Developing digital ecosystems and platforms that deliver traditional and non-traditional products to customers.
To remain competitive, banks must move beyond traditional service models and create integrated digital platforms. These ecosystems allow the delivery of both conventional banking products and innovative new services to customers in a seamless manner. This strategic shift focuses on relevance and agility, rather than just outsourcing tasks or hiring external talent without considering the bank's internal readiness.
- 45.** (C) Both I and II
A consortium of fifteen scheduled commercial banks established this specialized company in mid-2021 to advance blockchain adoption in the financial sector. Each participating institution holds an equal ownership stake of approximately six point six six percent. This collaborative approach ensures that the development of

digital infrastructure for banking is shared and standardized across major players in the industry.

- 46.** (A) II, IV, I, III
The evolution of financial technology began with major infrastructure projects like the first transatlantic cable in the mid-nineteenth century. This was followed by the introduction of telegraph-based fund transfers via FEDWIRE in 1918. Later, the first digital ATMs appeared in 1967, and the modern era of decentralized cryptocurrencies like Bitcoin emerged after the global financial crisis of 2008.
- 47.** (D) Intra-bank usage of Blockchain technology
When a financial institution establishes a private digital ledger for internal asset management and staff training, it is engaging in the intra-bank phase of adoption. This stage is crucial for building technical expertise and testing use cases before collaborating with other banks. It focuses on improving internal efficiency and control rather than facilitating cross-border payments or loan syndications with external partners.
- 48.** (D) Elimination of all regulatory requirements
While technology enhances the ease of doing business and improves management reporting, it does not remove the legal and regulatory obligations of financial institutions. In fact, modern systems often include tools to ensure stricter compliance with international laws. The goal of technological integration is to make processes more efficient and accurate, rather than bypassing the necessary oversight of governing authorities.
- 49.** (A) P-4, Q-1, R-2, S-3
Distributed ledgers streamline inter-bank operations by creating shared databases for customer verification and using smart contracts for real-time payment settlements. In lending, they automate underwriting by providing secure access to financial data. For capital markets, the technology reduces errors and shortens settlement times in the back office. These applications collectively enhance transparency and efficiency across various banking sectors.

- 50.** (C) EDPMS was operationalized by the Reserve Bank of India on March 1, 2014, for reporting lodgment and realization of export declarations. The export monitoring system was launched in early 2014 to track the declaration and realization of export proceeds electronically. It serves as a centralized platform where banks report transactions to ensure compliance with trade regulations. While the system has evolved to include automated caution listing and bank certificate issuance, its fundamental purpose remains the electronic tracking of physical export documents.
- 51.** (A) Manual process — Real-time review of draft terms of credit and immediate submission of obligation to pay to the export bank. Manual processes do not allow for the real-time review of draft terms of credit and immediate submission of obligation to pay to the export bank. Traditional paper-based credit processes are characterized by delays and do not allow for the real-time review of terms or immediate digital submission of payment obligations. These features are actually benefits introduced by blockchain technology. Manual methods are slow and often involve multiple document versions and physical signatures, leading to higher risks of miscommunication and errors compared to modern decentralized systems.
- 52.** (D) Outward Remittances Online
For individuals needing to send funds abroad to family members for maintenance, specialized online platforms provide a convenient and efficient solution. These transfers must stay within the limits prescribed by exchange management laws. Unlike trade portals or inward services, these platforms are specifically designed to facilitate the flow of money out of the country for personal reasons while ensuring regulatory compliance.
- 53.** (D) Assertion (A) is false, but Reason (R) is true. While technology significantly reduces the need for direct interaction in financial services, it is not possible to completely eliminate the human interface immediately. Automation handles repetitive tasks, but complex decisions and relationship management still require human oversight. Over time, the frequency of direct contact may decrease, but maintaining a human element remains necessary for handling unique situations and ensuring systemic trust.
- 54.** (C) Scrubbing remitters and beneficiaries to ensure compliance with international sanctions. Banks use global screening lists during online transfers to verify that neither the sender nor the receiver is associated with illegal activities or sanctioned entities. This process is a critical part of anti-money laundering and counter-terrorism financing protocols. It ensures that international transactions comply with global security standards, preventing the flow of funds to individuals or organizations restricted by international authorities.
- 55.** (A) P-3, Q-4, R-1, S-2
A digital bank offers full services through a smartphone, while a regulatory sandbox provides a controlled environment for testing new financial products. Cloud computing involves delivering servers and software over the internet for flexible resource management. Finally, a data breach refers to an incident where unauthorized individuals gain access to private information, highlighting the critical importance of cybersecurity.
- 56.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Banks require corporate clients to sign indemnity agreements when using online currency portals to mitigate risks associated with non-compliance. These agreements ensure the bank is protected if a client fails to provide the required underlying documentation after a trade is confirmed. This legal safeguard is essential because digital transactions happen instantly, while the submission of supporting evidence may follow later.
- 57.** (A) P2P Lending
This financial innovation uses digital platforms to connect individual borrowers directly with investors, bypassing traditional banking intermediaries. It allows for unsecured personal loans and provides investors with opportunities for higher returns compared to conventional savings. By using technology to match parties and manage transactions, it offers a more direct

May/June 2007

6. Which of the following pairs correctly identifies the two components of downside potential?
- Upside deviations and the generation of potential profits.
 - Potential losses and their corresponding probability of occurrence.
 - Sensitivity of parameters and the historical variance of data.
 - Market value of the asset and the square root of time factor.

Oct/Nov 2018

7. Which of the following statements is incorrect regarding EWRM?
- It is limited to a single event or circumstance impacting the organisation's functioning.
 - It encompasses the entire gamut of the organisation's operations.
 - It is a dynamic process involving people at all levels.
 - It takes a holistic picture of the entire organisation for the purpose of risk management.

May/June 2023

8. A bank's quantitative team calculates the 36-day volatility of a specific stock portfolio to be 18%. Using the square root of time rule, what is the daily volatility of this stock portfolio?
- 0.5%
 - 3%
 - 6%
 - 9%

Oct/Nov 2009

9. Consider the following factors for risk pricing:
- Cost of Deployable Funds
 - Operating Expenses
 - Loss Probabilities
 - Capital Charge
 - Profit Margin or Return on Networth
- Which combination of the above factors should be taken into account for risk pricing?
- I, II, III, and IV only
 - II, III, IV, and V only
 - I, III, IV, and V only
 - I, II, III, IV, and V

May/June 2016

10. Match the Enterprise Risk Management (ERM) key components in List I to their functional descriptions in List II:

List I: (ERM Key Components)

- Internal Environment
- Control Activities
- Risk Response
- Monitoring

List II: (Functional Descriptions)

- Selecting among risk avoidance, reduction, transfer, and acceptance
 - Establishes the risk philosophy and risk culture
 - Policies and procedures ensuring risk responses are executed
 - Reviewing the process and making necessary modifications
- P-2, Q-3, R-1, S-4
 - P-1, Q-4, R-2, S-3
 - P-3, Q-1, R-4, S-2
 - P-4, Q-2, R-3, S-1

Oct/Nov 2023

11. Consider the following requirements for keeping the divergence between planned performance and actual performance at acceptable levels:
- Strong Management Information System for reporting, monitoring and controlling risk.
 - Well laid out procedures and comprehensive risk reporting framework.
 - Risk management framework firmly embedded within operational departments without separate delineation.
 - Periodical review and evaluation.
- Which combination of the above statements represents the correct requirements?
- I, II, and III
 - II, III, and IV
 - I, II, and IV
 - I, III, and IV

May/June 2022

12. A retail banking division requires a yearly Probability of Default (PD) analysis for individual ratings and an updated Migration Chart. Which entity within the bank should handle this requirement?
- The Board of Directors of the bank.
 - Credit Risk Management Committee (CRMC).
 - Asset-Liability Management Committee (ALCO).
 - The bank's Treasury Mid Office Group.

1950s, followed by the first digital ATM in the late 1960s. Much later, modern payment systems like those from mobile technology giants were launched. More recently, specific regional versions of fintech emerged, particularly in Asia, focusing on local regulatory needs and advanced digital ecosystems.

67. (A) Only I

Artificial intelligence has the capability to evaluate a client's business intelligence by analyzing their financial health and the timing of their receivables. This sophisticated analysis provides insights into operational maturity and risk profiles. Contrary to the second statement, modern AI is also highly effective at credit scoring, using vast datasets to assess a borrower's ability and willingness to repay.

68. (D) Sydney

Sydney is recognized as a major global center for financial technology, where the industry makes a substantial contribution to the regional economy. This city accounts for approximately nine percent of the national gross domestic product through its robust ecosystem of startups and established firms. Its success highlights the growing importance of digital financial services in driving economic growth in major cities.

69. (A) I and II only

In capital markets, distributed ledger technology significantly improves efficiency by reducing trade errors and streamlining back-office operations. By providing a single, shared record of transactions, it minimizes the need for complex reconciliations. Rather than lengthening settlement times, the technology actually shortens them by enabling near-instantaneous verification and clearing, moving away from slow, manual review processes of the past.

70. (C) Artificial Intelligence

This technology simulates human cognitive processes to analyze complex scenarios and predict outcomes under various assumptions. By evaluating economic trajectories, it helps central banks and other institutions solve difficult problems related to international trade agreements. Unlike simple automation or decentralized ledgers, it focuses on high-level reasoning and data-driven modeling to inform

strategic decisions and understand potential future developments.

71. (B) I, II, and IV

Software robots are excellent at performing repetitive tasks such as collecting data from multiple sources and managing routine regulatory compliance reports. They also handle automated communication through emails and chatbots to improve customer engagement. However, the high-level predictive analysis of markets using complex mathematical algorithms is typically the domain of advanced data analytics and machine learning rather than basic automation.

72. (A) The use of advanced analytic techniques against very large, diverse sets of structured, semi-structured, and raw data.

The fundamental idea of this approach is to process and analyze massive volumes of varied information to find hidden patterns and insights. This includes everything from organized databases to unformatted digital records. By applying specialized tools to these large datasets, organizations can gain a deeper understanding of trends and behaviors that would be impossible to see using traditional methods.

73. (D) I, II, III, IV, and V

The timeline of banking technology includes foundational infrastructure like the transatlantic cable and the introduction of electronic fund transfers through telegraph. The mid-twentieth century saw the rise of modern credit cards, followed by the establishment of global secure messaging and digital exchanges. The 2008 financial crisis then served as a catalyst for the rapid growth of the modern era.

74. (B) Predictive analysis using Big Data

Financial institutions use historical records and sophisticated algorithms to model future consumer behavior through specialized analytical techniques. This process helps banks anticipate customer needs and identify potential risks or opportunities based on past trends. It relies on the ability to process vast amounts of data, rather than focusing on decentralized contracts, regulatory reporting automation, or simple repetitive task management.

and often faster alternative to the standard commercial lending process.

58. (C) September 1, 2018

The revised reporting form for foreign currency returns was officially introduced in late 2018 alongside a new consolidated reporting system. This update aimed to simplify the reporting requirements for foreign investments by merging various forms into a single master document. This implementation marked a significant step in the transition toward a more integrated and digitalized regulatory reporting framework.

59. (A) Defining the target architecture, operating model, resources, risk appetite, timelines, and costs.

A comprehensive plan for digital transformation must outline the desired technical structure, business processes, and necessary resources. It also requires a clear understanding of the bank's willingness to take risks and a detailed schedule of the associated costs. This roadmap serves as a strategic guide for transitioning from legacy systems to a modern, efficient digital banking environment.

60. (C) EDPMS

Before an authorized dealer bank can issue an electronic bank realization certificate, it must ensure that the export proceeds are accurately recorded in the centralized monitoring system. Banks are required to update this platform as soon as funds are received. This process ensures that the trade benefits claimed by exporters are based on verified data regarding the realization of proceeds.

61. (B) AD banks are prohibited from settling more than one Bill of Entry against a single Outward Remittance message.

AD banks are permitted to settle more than one Bill of Entry against a single Outward Remittance message. The import data processing system is designed with flexibility to accommodate various transaction structures in international trade. Contrary to the idea of strict one-to-one matching, banks are permitted to settle multiple entry documents against a single payment message. This functionality reflects the reality of trade operations where a single remittance may cover several different shipments or bills of entry.

62. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Using historical data to analyze past trends allows financial institutions to identify promising new markets and manage risks more effectively. By examining economic trajectories and political stability, banks can make informed decisions about where to expand their international trade portfolios. Therefore, data-driven insights from the past directly support the strategic development of future business opportunities in global trade.

63. (D) Integrating various foreign investment reporting types into a consolidated mechanism.

The primary goal of introducing a single master form was to streamline the complex reporting requirements for different types of foreign investments. By consolidating multiple reports into one digital interface, the process became more efficient for investors and more transparent for regulators. This centralized approach reduces the administrative burden on businesses and ensures that foreign investment data is consistent.

64. (A) P-3, Q-4, R-2, S-1

The development of financial technology followed a clear timeline, beginning with the establishment of global communication networks and stock exchanges in the late 1960s. Electronic funds transfer via FEDWIRE was an earlier innovation from 1918. In response to the 2008 financial crisis, the industry entered a new phase of growth, followed closely by the introduction of Bitcoin in 2009.

65. (B) Facilitating e-BRC issuance using only the data available within the EDPMS platform.

Requiring banks to update the export monitoring system on a real-time basis was intended to automate the issuance of bank realization certificates. By relying exclusively on verified digital records within the system, the process became faster and more reliable. This shift eliminated the need for manual data entry and reconciled records across different platforms, streamlining the workflow for exporters.

66. (B) III, II, IV, I

The history of financial technology began with the introduction of early charge cards in the

CHAPTER 11

Risk and Basic Risk Management Framework

NODIA

Oct/Nov 2014

1. Consider the following basic considerations for designing a risk management framework:
- I. Management of risk is a major concern for the top management.
 - II. Modern best practices consist of setting risk limits based on economic measures of risk.
 - III. Management of risks begins with their identification and quantification.
 - IV. Pricing of the transaction should be in accordance with the risk content.
 - V. Risk management requires a separate setup in the organization.

Which combination of the above statements should be taken into account?

- (A) I, II, III, and IV only
- (B) II, III, IV, and V only
- (C) I, III, IV, and V only
- (D) I, II, III, IV, and V

May/June 2021

2. Consider the following elements evaluated during the implementation of Enterprise-Wide Risk Management (EWRM):
- I. Adequacy of existing control processes.
 - II. Adequacy of existing management information system (MIS).
 - III. Process of responding to identified risks.
 - IV. Process of monitoring risks.
 - V. Process of identifying and assessing risk factors.

Which combination of the above represents the correct elements involved in EWRM implementation?

- (A) I, II, III, and IV only
- (B) II, III, IV, and V only
- (C) I, III, IV, and V only
- (D) I, II, III, IV, and V

Oct/Nov 2006

3. Consider the following characteristics regarding Volatility:

- I. It is a common statistical measure of dispersion around the average of any random variable.
- II. Volatility is the square root of the variance of the random variable.
- III. Variance is the sum of squared deviations divided by the number of observations.

Which combination of statements is correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2012

4. What is the most appropriate role of the 'Mid Office Group' within the risk management framework?
- (A) To clear new credit products put up by business units.
 - (B) To analyze frauds in the Bank and suggest mitigating measures.
 - (C) To oversee the Liquidity risk of the Bank.
 - (D) To monitor Treasury Operations on a real-time basis.

Oct/Nov 2025

5. Read the following assertion and reason and choose the correct option.
- Assertion (A): Implicit volatility has an advantage in risk measurement as it is forward-looking.
- Reason (R): Option prices being quoted in the market, which are used to derive implicit volatility, are also forward-looking.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

- (C) Interest rate gap risk
- (D) Liquidity risk

Oct/Nov 2007

35. Consider the following financial market segments:
- I. Government securities segment (outright, market repo and triparty repo).
 - II. USD-INR and forex forward segments.
 - III. Equity derivatives segment.
- For which of the above segments does the Clearing Corporation of India (CCIL) act as a central counterparty?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2014

36. Read the following assertion and reason and choose the correct option.
- Assertion (A): The minimum capital required for a business should be such that it is able to meet the maximum loss that may arise.
- Reason (R): In case trading results in a loss without any backup of capital support, the business would face bankruptcy.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2016

37. Which of the following statements is incorrect regarding the cost of business and risk?
- (A) Overestimation of loss on account of risks may result in underpricing.
 - (B) Risks in a business must be accounted for as a regular cost of business.
 - (C) A probability of loss is associated with all risks and factored into pricing.
 - (D) Underestimation of losses may result in lowering profits and planned RAROC.

May/June 2018

38. An entrepreneur owns five distinct businesses. In Year 2, cash inflows decrease in businesses A and C, but simultaneously increase in businesses

B, D, and E. Consequently, the variation in the net cash inflow of the total portfolio is substantially lower than individual businesses. What statistical concept causes this reduction in overall risk?

- (A) Positive correlation
- (B) Standard deviation maximization
- (C) Negative correlation
- (D) Capital preservation

Oct/Nov 2022

39. Two investments offer a total cash flow of Rs. 30,000 over five years. Investment 1 provides a steady Rs. 6,000 annually. Investment 2 provides highly variable cash flows ranging from -2,000 to 15,000 annually. Why would a rational investor demand a 14% return for Investment 2 compared to 12% for Investment 1?
- (A) To earn a risk premium for higher variability of cash flow.
 - (B) To offset higher time value associated with steady streams.
 - (C) To penalize the borrower for mathematical cash flow irregularities.
 - (D) To ensure that the initial investment is perfectly amortized.

May/June 2005

40. Consider the following statements regarding Risk Adjusted Return on Capital (RAROC):
- I. RAROC is a better performance measure than Return on Assets (ROA) because it captures the vital factor of risk taken.
 - II. Return on Equity (ROE) reliably captures risks in the revenue model.
 - III. RAROC allows one to compare two businesses with different risk profiles.
 - IV. A transaction may give a higher return but at a higher risk.
- Which combination of statements is correct?
- (A) I, II, and III
 - (B) II, III, and IV
 - (C) I, III, and IV
 - (D) I, II, and IV

Oct/Nov 2010

41. A bank branch extends credit exposure to 100 independent borrowers. Each individual borrower is classified at 'level 2' risk. What will be the expected portfolio risk level for these combined 100 accounts?
- (A) Exactly level 2 risk

Oct/Nov 2020

13. How are 'Risks' defined in the context of business expectations?
- (A) Uncertain outcomes affecting planned business objectives
 - (B) Certainties resulting in expected variations in results
 - (C) Absolute losses incurred due to operational inefficiencies
 - (D) Imprecise knowledge regarding future historical events

May/June 2011

14. Consider the following dimensions of the COSO Enterprise Risk Management (ERM) framework:
- I. Internal Environment is one of the eight key components.
 - II. Compliance is one of the four key objectives.
 - III. Risk Response is one of the eight key components.
 - IV. Subsidiary is one of the organizational levels.
- Which combination of the above statements is correct?
- (A) I, II, and III only
 - (B) II, III, and IV only
 - (C) I, III, and IV only
 - (D) I, II, III, and IV

Oct/Nov 2012

15. Match the organizational layers from the COSO ERM Framework in List I to their descriptive tiers in List II:
- List I: (Organizational Layers)
- P. Entity-Level
 - Q. Division
 - R. Business Unit
 - S. Subsidiary
- List II: (Descriptive Tiers)
- 1. Lowest distinct operational tier
 - 2. Second operational tier
 - 3. Third operational tier
 - 4. Highest consolidated tier of the framework
- (A) P-2, Q-3, R-1, S-4
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-4, Q-2, R-3, S-1

May/June 2015

16. Which of the following statements is correct regarding reports received by senior management or the board of directors?
- (A) Evaluate trends of material risks and their effect on capital levels.
 - (B) Focus exclusively on historical profitability without assessing risk profiles.
 - (C) Evaluate the absolute accuracy of transaction-level pricing models alone.
 - (D) Replace the independent internal audit function across the entire bank.

Oct/Nov 2013

17. Consider the following statements regarding Enterprise Risk Management (ERM):
- I. As the risks keep constantly changing and evolving in a global economy, ERM is a never ending journey.
 - II. ERM helps to ensure effective reporting and compliance with laws and regulations.
- Which of the statements is/are correct?
- (A) Only I is correct
 - (B) Only II is correct
 - (C) Both I and II are correct
 - (D) Neither I nor II is correct

May/June 2008

18. What does the statement "Uncertainty is mother of risk" imply?
- (A) Uncertainty always leads directly to absolute financial losses.
 - (B) Risk generates uncertainty within the global financial markets.
 - (C) Uncertainty eliminates the need to assess probability distributions.
 - (D) Uncertainty precedes the manageable risk situations in business.

Oct/Nov 2017

19. From which date did the RBI mandate banks to migrate to the MCLR mechanism to improve the efficiency of monetary policy transmission?
- (A) 1st July 2010
 - (B) 1st April 2016
 - (C) 1st April 2020
 - (D) 1st January 2003

May/June 2006

20. Whatever improvements are carried out by RBI in the lending rate mechanism, banks must ensure specific costs and factors are loaded in

the interest rate chargeable to the borrower. All of the following are such factors, EXCEPT:

- (A) Cost of Deposits and other funding sources.
- (B) Capital Charge for regulatory compliance.
- (C) Operating Expenses of the business unit.
- (D) Depreciation of bank-owned fixed properties.

Oct/Nov 2008

21. Consider the following statements regarding the estimation of losses and pricing:
- I. Overestimation of loss on account of risks may result in overpricing resulting in loss of business.
 - II. Underestimation of losses may result in lowering of profits, which would affect planned RAROC.
 - III. There is a probability of loss associated with all risks which is factored into pricing.
- Which combination of statements is correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2024

22. The calculation of historical mean and volatility based on a defined time series requires defining all of the following, EXCEPT:
- (A) The strike price of the option
 - (B) The period of observation
 - (C) The frequency of observation
 - (D) A set of historical data

Oct/Nov 2021

23. A commodity trader decides to eliminate price uncertainty by entering into a rigid forward sale contract. While this ensures stability in his net cash flows, what critical aspect of risk mitigation does he experience when market prices suddenly skyrocket?
- (A) His downside potential converts into immediate bankruptcy.
 - (B) His capital requirement for operations doubles overnight.
 - (C) His upside potential of profits is foreclosed and reduced.
 - (D) His structural control over operational risks is compromised.

May/June 2013

24. Consider the following statements regarding the essence of risk management:
- I. It requires identifying, measuring, controlling, and mitigating risks.
 - II. It requires estimating the costs of risk.
 - III. It is a job that requires special skills and is oriented towards the control aspect of business.
 - IV. It does not require a well-defined framework to guide the risk management function.
- Which combination of statements is correct?
- (A) I, II, and III
 - (B) I, III, and IV
 - (C) II, III, and IV
 - (D) I, II, and IV

Oct/Nov 2015

25. Consider the following statements regarding modern best practices in risk management:
- I. They consist of setting risk limits based on economic measures of risk.
 - II. They ensure the best risk adjusted return keeping in view the invested capital.
 - III. They promote taking risks without constraints of available capital.
- Which combination of statements is correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2020

26. Read the following assertion and reason and choose the correct option.
- Assertion (A): Risk mitigation measures aim to reduce downside variability in net cash flow, but they simultaneously reduce the upside potential.
- Reason (R): Entering into various contracts to contain uncertainty forecloses the option to take advantage of favorable price movements.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

27. A retired person invests Rs. 1 lakh at 6.50% interest payable half-yearly in a 5-year RBI bond. Which of the following best characterizes this investment?
- (A) High-risk investment with significant variability in net cash flow.
 (B) Zero-risk investment with no variation and relatively lower returns.
 (C) Medium-risk investment because the principal is blocked for 5 years.
 (D) Uncertain investment because inflation may erode the real interest rate.

May/June 2017

28. Match the types of risks in List I to their corresponding risk mitigation techniques in List II:

List I: (Types of Risk)

- P. Credit risk
 Q. Interest rate risk
 R. Forex risk
 S. Equity price risk

List II: (Mitigation Techniques)

1. Mitigated using forward rate agreements
 2. Mitigated using equity options
 3. Offset using credit derivatives
 4. Mitigated using options or futures
 (A) P-2, Q-3, R-1, S-4
 (B) P-1, Q-4, R-2, S-3
 (C) P-3, Q-1, R-4, S-2
 (D) P-4, Q-2, R-3, S-1

Oct/Nov 2024

29. All of the following are responsibilities of the Board of Directors with regard to risk management, EXCEPT:
- (A) Setting up operating prudential limits for the line management.
 (B) Articulating aggregate risk limits for the entire organization.
 (C) Deciding the comprehensive risk management policy of the bank.
 (D) Articulating review mechanisms and internal reporting systems.

May/June 2010

30. What is the most appropriate reason why underestimation of losses affects planned RAROC?
- (A) It increases the probability of super profits, skewing the metric.

- (B) It lowers profits, reducing returns against allocated capital.
 (C) It necessitates an immediate increase in internal capital generation.
 (D) It leads to severe overpricing and subsequent loss of market share.

Oct/Nov 2011

31. In which month and year was the Clearing Corporation of India (CCIL) set up to act as a Central Counterparty (CCP) to provide clearing and settlement?
- (A) April 2016
 (B) July 2010
 (C) April 2001
 (D) January 2003

May/June 2009

32. Which of the following pairs correctly matches the senior-level executive sub-group with its role?
- (A) ALCO — Recommends Base Rate or MCLR of the bank to the Board.
 (B) CRMC — Oversees the Liquidity risk and cash flows of the bank.
 (C) ORMC — Conducts portfolio analysis for various retail loan assets.
 (D) Mid Office Group — Ensures robustness of all credit rating processes.

Oct/Nov 2019

33. Consider the following statements regarding aggregated risk and capital requirements:
- I. Aggregated risk determines capital needs.
 II. The incremental risk in the portfolio is always equal to the sum of the risks taken at the transaction level.
- Which of the statements is/are correct?
- (A) Only I is correct
 (B) Only II is correct
 (C) Both I and II are correct
 (D) Neither I nor II is correct

May/June 2025

34. A trader enters into a purchase contract to eliminate the uncertainties associated with purchase price fluctuations. However, by relying on the seller to deliver the goods at the future date, what new risk element does the trader bring into the process?
- (A) Basis risk
 (B) Counterparty risk

75. (B) I, II, IV, and V

This field represents the powerful combination of financial services and digital innovation, which streamlines traditional processes and enables new business models. It leverages tools like chatbots and advanced machine learning to improve service delivery across all types of financial institutions. It is not limited to specific groups like credit unions but serves the entire financial landscape, including traditional banks.

76. (C) Transparent factoring of invoices on a distributed digital ledger.

While automation excels at data collection, compliance management, and streamlining routine transactions, it does not involve the use of decentralized ledgers for asset tracking. Factoring on a shared ledger is a specific application of blockchain technology, which provides a transparent and immutable record of ownership. Software robots focus on performing tasks within existing systems rather than creating new decentralized ones.

77. (B) Insist the corporate execute a one-time Indemnity agreement.

To manage the risk of missing documentation for online currency trades, banks require corporate clients to sign a legal protection document. This agreement holds the client responsible for any losses that might occur if they fail to comply with regulatory document requirements after a deal is confirmed. This step is a necessary part of onboarding to ensure the bank remains protected.

78. (C) Invoice factoring risk

In manual trade finance, there is a significant risk that an exporter might use the same contract to obtain short-term financing from multiple lenders. This happens because individual banks often cannot verify in real-time whether the same transaction has already been funded elsewhere. Decentralized ledgers solve this problem by providing a single, transparent record that prevents multiple banks from financing the same invoice.

79. (D) Proof of ownership provided within the blockchain.

Decentralized technology allows for the secure and transparent tracking of goods and their ownership titles during the shipping process. By

recording every transfer of responsibility on a digital ledger, all parties gain immediate visibility into the status and location of a shipment. This eliminates the need to rely on slow manual updates from intermediary banks or third-party inspectors to confirm ownership.

80. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The use of distributed ledgers in international finance significantly lowers the risk of digital attacks because every entry is encrypted. Furthermore, since the data is stored across a wide network of computers rather than in one central location, it is much harder for hackers to compromise the entire system. This structural security and encryption together provide a robust defense against cyber threats.

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- (B) Higher than level 2 risk due to cumulative probability
- (C) Lower than level 2 risk due to the effect of diversification
- (D) Zero risk, as the sheer volume guarantees statistical certainty

May/June 2021

42. How does the guidance for risk-taking flow within an organization?
- (A) Risk preference is determined at the transaction level and aggregated upwards.
 - (B) Risk preference is a corporate issue with guidance emanating from the top.
 - (C) Transaction level risk guidance operates independently of enterprise strategies.
 - (D) Total enterprise-wide risk is solely determined by the line management team.

Oct/Nov 2014

43. Branch B extends a loan linked to the bank's MCLR while funding it entirely with a fixed-rate deposit of the same maturity. If the MCLR is reduced mid-term, what specific risk directly materializes for the bank?
- (A) Funding Risk
 - (B) Reinvestment Risk
 - (C) Time Risk
 - (D) Basis Risk

May/June 2012

44. What is the definition of "Sensitivity" in risk measurement?
- (A) The sum of observed values divided by the number of observations.
 - (B) Deviation of a target variable due to unit movement of a parameter.
 - (C) The standard deviation of the values of different target variables.
 - (D) The probability distribution of potential extreme financial losses.

Oct/Nov 2025

45. Consider the following steps involved in the implementation of Enterprise-Wide Risk Management (EWRM):
1. Review of the internal environment to assess risk philosophy and culture
 2. Review of the process of setting objectives
 3. Assessment of the existing mechanism of identifying risk-factors
 4. Formulation of a road map for the

implementation plan

Which of the following is the correct logical sequence for implementation?

- (A) 2, 1, 4, 3
- (B) 1, 2, 3, 4
- (C) 4, 3, 2, 1
- (D) 2, 4, 1, 3

May/June 2007

46. Match the risk measures in List I to their corresponding targets or descriptions in List II:
- List I: (Risk Measures)

- P. Interest rate gap
- Q. Value at Risk (VaR)
- R. Duration
- S. Volatility

List II: (Targets/Descriptions)

1. Sensitivity of the interest rate margin of the banking book
 2. Sensitivity of investment portfolio or trading book
 3. Standard deviation of the values of variables
 4. A downside risk measure
- (A) P-2, Q-3, R-1, S-4
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-4, Q-2, R-3, S-1

Oct/Nov 2018

47. From which language is the word 'Risk' derived, originally meaning 'to dare'?
- (A) Classical Latin
 - (B) Early Italian
 - (C) Ancient Greek
 - (D) Modern Spanish

May/June 2023

48. Consider the following statements regarding downside potential in risk measurement:
- I. The correct risk measurement should ignore the upside potential and take into account only the downside potential.
 - II. Downside potential requires prior modelling of the probability distribution of potential losses.

Which of the statements is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

May/June 2013

64. All of the following statements regarding traditional approaches versus RAROC are correct, EXCEPT:
- (A) ROE is computed from financial statements and fully captures risks in the revenue model.
 - (B) Traditional approaches like ROA do not adequately evaluate the performance of business lines based on risk taken.
 - (C) RAROC allows comparison of two businesses with different volatility of returns.
 - (D) The higher the RAROC, the higher is the reward to investors/shareholders.

Oct/Nov 2015

65. What is a critical outcome that Enterprise risk management (ERM) helps an entity achieve besides effective reporting and compliance?
- (A) Avoiding damage to the entity's reputation and associated consequences.
 - (B) Identifying a zero-risk environment for all structural business units.
 - (C) Guaranteed elimination of all market volatility metrics.
 - (D) Foreclosing all possibilities of upside profit potential across transactions.

May/June 2020

66. Which of the following statements regarding the linkage between risk and capital is correct?
- (A) Lower variation in net cash flow would require higher capital.
 - (B) Wide variations in net cash flow would have lower loss possibilities.
 - (C) Higher variability in cash flow requires higher capital for losses.
 - (D) Profit and loss possibilities are lower in high variability businesses.

Oct/Nov 2005

67. Match the entities in the risk management organization in List I to their primary roles in List II:

List I: (Entities)

- P. Board of Directors
- Q. Risk Management Committee
- R. Committee of senior-level executives
- S. Risk management support group

List II: (Roles)

- 1. Responsible for implementation of risk and

business policies simultaneously

- 2. Has the overall responsibility for management of risks
 - 3. Board level Sub-Committee that ensures robustness of risk measurement models
 - 4. Responsible for independent risk monitoring, measurement, analysis and reporting
- (A) P-2, Q-3, R-1, S-4
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-4, Q-2, R-3, S-1

May/June 2017

68. Consider the following responsibilities:
- I. Setting guidelines for risk management and reporting.
 - II. Ensuring robustness of risk measurement models.
 - III. Monitoring Treasury Operations on real-time basis.
- Which of these are responsibilities of the Risk Management Committee (RMC)?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2024

69. A trading business purchases a large quantity of goods for sale. Shortly after the purchase, the unit price undergoes a permanent structural decline. Which of the following is the most likely consequence if the loss potential is not controlled?
- (A) The business will experience a temporary but manageable drop.
 - (B) Losses can wipe out capital employed, resulting in bankruptcy.
 - (C) Uncertainty in administrative costs will automatically hedge the drop.
 - (D) The business will immediately generate a risk premium to cover it.

May/June 2010

70. A bank wishes to revise its Marginal Cost of funds based Lending Rate (MCLR) to improve the NIM of the Bank. Which sub-group of senior executives is directly responsible for recommending this to the Board?
- (A) Credit Risk Management Committee (CRMC)

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(D) Neither I nor II is correct

Oct/Nov 2013

57. Which of the following statements regarding external benchmarks is incorrect?

- (A) The RBI mandated linking new floating rate retail loans to external benchmarks from April 01, 2020.
- (B) RBI instructed that benchmarks must be developed exclusively by FEDAI.
- (C) Most banks have preferred to link their retail lending rates to RBI's Repo Rate.
- (D) One of the flaws of the MCLR system was that it was an internal benchmark of the banks.

May/June 2008

58. An investment analyst is trying to assess the metric that captures the market's view of the likelihood of futuristic movements in a given security's price to price an option contract. Which metric must the analyst use?

- (A) Historical Volatility
- (B) Value at Risk
- (C) Downside Potential
- (D) Implicit Volatility

Oct/Nov 2017

59. Consider the following elements for monitoring and controlling risk within a bank's internal control structure:

- I. Independent review and involvement of internal or external audits.
- II. Developing a system to relate risk to the bank's capital level.
- III. Periodic reviews to ensure integrity, accuracy, and reasonableness.
- IV. Identification of large exposures and risk concentrations.
- V. Stress testing and analysis of assumptions and inputs.

Which combination of the above elements reflects effective control processes?

- (A) I, II, III, and IV only
- (B) II, III, IV, and V only
- (C) I, III, IV, and V only
- (D) I, II, III, IV, and V

May/June 2006

60. Which of the following pairs is incorrectly matched?

- (A) Variation in sales volume — Risk element

- (B) Equity trading — Business with higher risk
- (C) Administrative and transportation costs — Risk element
- (D) RBI Bond @ 6.50% — High-risk investment

Oct/Nov 2008

61. What is the precise definition of 'Risk Mitigation'?

- (A) Maximizing the upside potential by leveraging unhedged market positions.
- (B) Adopting strategies that reduce uncertainties linked to risk elements.
- (C) Aggregating various risks into a single quantitative downside measure.
- (D) Accepting all transaction-level uncertainties without any capital charge.

May/June 2024

62. A bank maintains a mandatory CRR of 4.5% with the RBI, on which it earns absolutely no interest. When calculating the final interest rate to charge a new borrower, how should the bank handle this regulatory requirement?

- (A) Load the negative impact of the CRR contribution into the lending rates.
- (B) Absorb the loss completely within the bank's general operational expenses.
- (C) Subtract the CRR percentage directly from the expected profit margin.
- (D) Ignore the CRR as it does not affect the pool of deployable funds.

Oct/Nov 2021

63. Consider the following functions within a banking operational risk framework:

- I. Ensuring the robustness of Operational risk in the Bank.
- II. Analysis of the Frauds in the Bank.
- III. Recommending mitigating measures for non-recurrence of frauds.
- IV. Clearing any new credit products put up by business units.
- V. Clearing any new non-credit products put up by business units.

Which combination of the above functions belongs to the Operational Risk Management Committee (ORMC)?

- (A) I, II, III, and IV only
- (B) I, II, III, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

May/June 2018

78. All of the following are alternative risk responses identified and selected among in Enterprise risk management (ERM), EXCEPT:
- (A) Risk avoidance
 - (B) Risk reduction
 - (C) Risk transfer
 - (D) Risk multiplication

Oct/Nov 2022

79. How is Enterprise-Wide Risk Management (EWRM) defined?
- (A) A localized tactic to maximize the upside potential of a single highly profitable unit.
 - (B) A structured process of identifying, prioritizing, and mitigating risks holistically.
 - (C) A process focused exclusively on identifying internal risk factors for compliance.
 - (D) A theoretical model used only for calculating historical volatility in equity pricing.

May/June 2005

80. Consider the following statements regarding the drawbacks of sensitivity analysis:
- I. It references only one market parameter and does not consider simultaneous changes in other parameters.
 - II. It assumes that market environments will remain constant regardless of prevailing conditions.
 - III. It depends on prevailing conditions and changes as the market environment changes.
 - IV. The predictions arrived at would be correct only if the market moves exactly in the same fashion as it moved in the past.
- Which combination of the above statements accurately reflects the drawbacks?
- (A) I, II, and III
 - (B) II, III, and IV
 - (C) I, III, and IV
 - (D) I, II, and IV

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- (B) Operational Risk Management Committee (ORMC)
- (C) Risk Management Support Group
- (D) Asset-Liability Committee (ALCO)

Oct/Nov 2011

71. Which of the following statements regarding capital requirements is incorrect?
- (A) The capital requirement of a business depends upon the risks associated with its revenue model.
 - (B) Expected return on an investment also factors in the risks associated with it.
 - (C) The higher the risks in a business model, the higher would be the capital requirement and return expectations.
 - (D) A business with lower variation in net cash flow would be a business requiring higher capital backup.

May/June 2009

72. Why is the risk associated with a portfolio always less than the weighted average of risks of individual items in the portfolio?
- (A) Portfolio management eliminates all systematic market parameters.
 - (B) Weighted averages inherently amplify downside potential mathematically.
 - (C) Capital charges are waived for portfolios exceeding 100 separate items.
 - (D) Diversified portfolio items do not behave in a unidirectional manner.

Oct/Nov 2019

73. Which of the following pairs is incorrectly matched regarding the Risk Management Support Group?
- (A) Mid Office Group — Liquidity Risk
 - (B) Asset/Liability Group — Market Risk (Liquidity, Interest rate and Forex)
 - (C) Credit Risk Group — Credit Risk
 - (D) Operational Risk Group — Operational and Residual risk

May/June 2025

74. Read the following assertion and reason and choose the correct option.
- Assertion (A): Any new product or deviation from directed procedures adds to the risk content of the exposure and needs clearance at the corporate level.
- Reason (R): Risk return characteristics and

risk quantification form the basis of decision-making, as taking risks at the transaction level impacts the aggregated portfolio risk.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2007

75. Consider a bank extending a 5-year loan with a 1-year moratorium, funded by a 3-year deposit. Arrange the following risks in the chronological order they are likely to emerge during the life of this transaction:
1. Funding Risk
 2. Time Risk
 3. Basis Risk
 4. Gap or Mismatch Risk
- Select the correct sequence:
- (A) 3, 1, 2, 4
 - (B) 1, 3, 4, 2
 - (C) 1, 2, 3, 4
 - (D) 3, 4, 1, 2

May/June 2014

76. What is the most appropriate description of the criticality of risk management in an organization?
- (A) It is solely used to maximize the upside potential of net cash flows.
 - (B) It completely eliminates the probability of minor operational variations.
 - (C) It ensures survival during severely adverse business situations.
 - (D) It guarantees steady generation of profits regardless of conditions.

Oct/Nov 2016

77. A corporate borrower suddenly prepays a large 10-year term loan after only 3 years. The bank now faces the challenge of managing the returned funds. What specific risk did the premature withdrawal introduce into the transaction?
- (A) General Funding Risk
 - (B) Specific Default Risk
 - (C) Embedded Option Risk
 - (D) Operational Process Risk

9. (D) I, II, III, IV, and V

Accurate risk pricing requires the integration of several financial factors to ensure profitability and stability. These include the cost of deployable funds, operating expenses, and expected loss probabilities. Additionally, incorporating a capital charge and a target profit margin or return on net worth ensures that the interest rate charged reflects the underlying risk content.

10. (A) P-2, Q-3, R-1, S-4

Enterprise Risk Management components include the internal environment, which establishes risk culture and philosophy. Control activities involve policies and procedures to execute risk responses. Risk response itself focuses on selecting strategies like avoidance, reduction, transfer, or acceptance. Finally, monitoring involves reviewing the entire process and making necessary modifications to maintain effectiveness over time.

11. (C) I, II, and IV

Maintaining acceptable levels of divergence between planned and actual performance requires a strong management information system. This must be supported by well-defined procedures, a comprehensive reporting framework, and periodic evaluations. Such a structured approach ensures that risks are effectively monitored and controlled, facilitating the alignment of operational outcomes with the organization's strategic business objectives.

12. (B) Credit Risk Management Committee (CRMC).

The Credit Risk Management Committee is responsible for overseeing the credit risk profile of the bank. This includes high-level analytical tasks such as conducting yearly Probability of Default analyses for individual ratings and updating Migration Charts. These functions are essential for assessing the creditworthiness of the portfolio and ensuring that credit risks are properly managed.

13. (A) Uncertain outcomes affecting planned business objectives

In a business context, risks are defined as uncertain outcomes that can negatively impact the achievement of planned objectives. These uncertainties arise from various internal and external factors, leading to variations in results.

Understanding risk as an unpredictable deviation from expected outcomes allows organizations to implement strategies to manage and mitigate potential adverse effects.

14. (D) I, II, III, and IV

The COSO Enterprise Risk Management framework consists of eight key components, including the internal environment and risk response. It also defines four key objectives, such as compliance with laws and regulations. Furthermore, the framework applies across multiple organizational levels, including subsidiaries, providing a comprehensive structure for managing risks and achieving strategic entity goals.

15. (D) P-4, Q-2, R-3, S-1

The COSO Enterprise Risk Management Framework organizes an entity into distinct layers for risk assessment. The entity-level represents the highest consolidated tier, followed by divisions and then subsidiaries. The business unit is classified as the lowest distinct operational tier. This hierarchical structure ensures that risk management is applied consistently from the top down to individual units.

16. (A) Evaluate trends of material risks and their effect on capital levels.

Reports submitted to senior management or the board of directors are essential for high-level oversight. These documents must evaluate trends in material risks and assess their potential impact on the bank's capital levels. By focusing on these strategic areas, the reports enable leadership to make informed decisions regarding risk appetite, capital adequacy, and overall business strategy.

17. (C) Both I and II are correct

Enterprise Risk Management is a continuous process necessitated by the constantly evolving risks in a global economy. It plays a vital role in ensuring that an organization maintains effective reporting standards and complies with all relevant laws and regulations. This ongoing journey allows entities to adapt to new threats while safeguarding their reputation and operational integrity.

ANSWERS

1. (D) I, II, III, IV, and V
Designing a robust risk management framework necessitates a multi-dimensional approach involving top management oversight. It incorporates identifying and quantifying risks while setting limits through economic measures. Furthermore, establishing a separate organizational setup ensures that transaction pricing accurately reflects risk content. This comprehensive strategy facilitates the holistic management of uncertainties within the business environment.
2. (D) I, II, III, IV, and V
Implementing Enterprise-Wide Risk Management involves evaluating existing control processes and management information systems to ensure adequacy. The process encompasses identifying and assessing risk factors while establishing structured responses and monitoring mechanisms. This systematic evaluation allows the organization to address potential threats across all operational layers, ensuring that risk management is integrated and comprehensive.
3. (D) I, II, III, and IV
Volatility serves as a fundamental statistical measure representing the dispersion of a random variable around its average. It is mathematically defined as the square root of the variance. Variance itself is calculated by dividing the sum of squared deviations by the total number of observations, providing a clear indication of variability within a dataset.
4. (D) To monitor Treasury Operations on a real-time basis.
The Mid Office Group plays a crucial role in a bank's risk management framework by providing independent oversight. Its primary function involves monitoring treasury operations on a real-time basis to ensure compliance with risk limits. This group acts as a bridge between the front and back offices, focusing on risk identification and control.
5. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Implicit volatility is highly valued in risk measurement due to its forward-looking perspective. It is derived directly from option prices currently quoted in the market, which reflect the collective expectations of market participants regarding future price movements. This characteristic makes it a more predictive tool for assessing potential market variations compared to historical data.
6. (B) Potential losses and their corresponding probability of occurrence.
Risk measurement focusing on downside potential specifically identifies two critical components. These are the potential financial losses that may be incurred and their corresponding probability of occurrence. By isolating these elements, organizations can better understand the severity and likelihood of adverse outcomes, allowing for more precise capital allocation and risk mitigation strategies.
7. (A) It is limited to a single event or circumstance impacting the organisation's functioning.
Enterprise-Wide Risk Management is defined by its holistic and dynamic nature, involving personnel at every level of the organization. Unlike traditional approaches, it does not limit itself to single events or isolated circumstances. Instead, it encompasses the entire range of operations to provide a comprehensive picture of the risks impacting the organization's functioning.
8. (B) 3%
The square root of time rule is used to convert volatility across different time horizons. For a portfolio with an eighteen percent volatility over thirty-six days, the daily volatility is calculated by dividing the total volatility by the square root of thirty-six. This calculation results in a daily volatility of exactly three percent.

Oct/Nov 2009

49. Which downside risk measure integrates sensitivity and volatility with the adverse effect of uncertainty and is heavily relied upon by the banking industry and regulators?
- (A) Value at Risk (VaR)
(B) Gap analysis
(C) Historical Volatility
(D) Duration

May/June 2016

50. Read the following assertion and reason and choose the correct option.
Assertion (A): The cost of funds used in pricing should correspond to the specific term for which it is deployed.
Reason (R): Five-year funds generally have a different cost than one-year funds due to the time value of money.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2023

51. Which framework released by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) has been adapted by banks to drive initiatives in risk management beyond Basel norms?
- (A) Standard Deviance Control Framework
(B) Central Counterparty Regulatory Framework
(C) Enterprise Risk Management Framework
(D) Transactional Risk Assessment Framework

May/June 2022

52. What distinguishes risk from uncertainty?
- (A) Uncertainty is a priced situation, while risk is a clouded situation.
(B) Risk is imprecise knowledge, while uncertainty is a probability distribution.
(C) Risk is assessable uncertainty, while uncertainty is imprecise knowledge.
(D) Neither concept is distinct; both imply a lack of future knowledge.

Oct/Nov 2020

53. Which of the following statements correctly highlights a key reason for risk measurement at the transaction level?
- (A) Pricing of the transaction is solely determined by macro-economic indicators.
(B) Transaction-level risk is always zero when guaranteed by the bank Board.
(C) Transaction risks are entirely offset by the aggregate portfolio margin.
(D) Pricing requires risk content to be instrumental in evaluating exposure.

May/June 2011

54. Which of the following is correct regarding RAROC?
- (A) It ignores the risk taken by the bank to generate returns.
(B) It is an inferior measure compared to traditional Return on Equity.
(C) It compares businesses with different volatility of return profiles.
(D) It does not seek enhancement in the risk-adjusted return on capital.

Oct/Nov 2012

55. A bank funds a 5-year commercial loan using short-term 1-year deposit costs for its pricing calculation. Later, interest rates rise significantly, squeezing the bank's margins. What essential pricing principle was ignored?
- (A) Risk pricing implies factoring a capital charge into the calculation.
(B) Pricing must factor historical volatility over a defined 36-day period.
(C) Cost of funds should correspond to the term of deployment.
(D) Operational expenses are bank-specific and must be loaded separately.

May/June 2015

56. Consider the following statements regarding risk variability:
- I. Lower risk implies lower variability in net cash flow with lower upside and downside potential.
II. Higher risk would imply higher upside and downside potential.
- Which of the statements is/are correct?
- (A) Only I is correct
(B) Only II is correct
(C) Both I and II are correct

18. (D) Uncertainty precedes the manageable risk situations in business.

The phrase “uncertainty is the mother of risk” suggests that uncertainty is the precursor to manageable risk. While uncertainty involves imprecise knowledge about the future, risk represents a situation where those uncertainties are assessed and quantified. Therefore, uncertainty exists before specific risk situations are identified and addressed within the framework of a business strategy.

19. (B) 1st April 2016

The Reserve Bank of India introduced the Marginal Cost of funds based Lending Rate mechanism effective from April first, two thousand sixteen. This transition was designed to improve the efficiency of monetary policy transmission by ensuring that lending rates more accurately reflect the current cost of funds for banks, thereby benefiting borrowers and the broader economy.

20. (D) Depreciation of bank-owned fixed properties. When determining lending rates, banks must factor in several critical costs including the cost of funds, capital charges for regulatory compliance, and operating expenses. However, the depreciation of bank-owned fixed properties is generally considered a general accounting expense rather than a direct component loaded into the interest rate charged to a specific borrower for a transaction.

21. (D) I, II, and III

Risk pricing requires a delicate balance; overestimating potential losses can lead to overpricing and loss of business. Conversely, underestimating losses reduces profits and negatively affects the planned risk-adjusted return on capital. Because all risks carry a probability of loss, these must be accurately factored into the pricing model to ensure sustainable business growth and profitability.

22. (A) The strike price of the option

Calculating historical mean and volatility requires a defined set of historical data, a specific period of observation, and a consistent frequency of observation. However, the strike price of an option is a parameter used in the valuation of derivatives and the calculation of

implicit volatility, rather than the determination of historical statistical measures based on time series.

23. (C) His upside potential of profits is foreclosed and reduced.

By entering into a rigid forward sale contract, a trader successfully eliminates price uncertainty and stabilizes cash flows. However, this action also forecloses the upside potential of profits. If market prices rise significantly, the trader is bound by the contract price and cannot benefit from the higher market rates, effectively capping their potential financial gain.

24. (A) I, II, and III

Risk management involves identifying, measuring, controlling, and mitigating various risks while accurately estimating their associated costs. This specialized function requires specific skills and a focus on business control aspects. Furthermore, it must be guided by a well-defined framework to ensure that risk-taking activities align with the organization's overall strategic goals and available capital.

25. (A) I and II only

Modern risk management practices focus on setting risk limits based on economic measures. These practices ensure that an organization achieves the best risk-adjusted return relative to the invested capital. By linking risk-taking to available capital, firms can optimize their performance while maintaining stability, rather than taking unconstrained risks that could jeopardize the financial health of the entity.

26. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Risk mitigation strategies are designed to reduce the variability of net cash flows by containing uncertainty. While this protects against downside losses, it simultaneously reduces the upside potential. This occurs because entering into fixed contracts or hedges forecloses the ability to take advantage of favorable market movements, as the terms are set to minimize overall fluctuation.

- 27. (B)** Zero-risk investment with no variation and relatively lower returns.
An investment in an RBI bond with a fixed interest rate and a set maturity period is considered a zero-risk investment. Such instruments provide no variation in net cash flows, as the returns are guaranteed by the sovereign. Consequently, while the investment is safe, it typically offers lower returns compared to assets with higher risk and variability.
- 28. (C)** P-3, Q-1, R-4, S-2
Different risks require specific mitigation techniques. Credit risk can be offset using credit derivatives, while interest rate risk is managed through forward rate agreements. Forex risk is often mitigated using options or futures contracts, and equity price risk is managed through equity options. These tools allow organizations to hedge against unfavorable movements in various market parameters.
- 29. (A)** Setting up operating prudential limits for the line management.
The Board of Directors is responsible for high-level risk management, including articulating aggregate risk limits and deciding comprehensive policies. It also oversees review mechanisms and internal reporting systems. However, setting specific operating prudential limits for line management is typically an executive management function, as it involves the day-to-day implementation of the Board's broader strategic risk directives.
- 30. (B)** It lowers profits, reducing returns against allocated capital.
Underestimating potential losses directly impacts the risk-adjusted return on capital by lowering the actual profits earned. Since RAROC measures the return relative to the capital allocated for risk, any reduction in profit decreases the overall ratio. This misalignment means that the bank is not being adequately compensated for the true level of risk it has assumed.
- 31. (C)** April 2001
The Clearing Corporation of India was established in April two thousand one. It functions as a central counterparty, providing clearing and settlement services for various financial market segments. By interposing itself between buyers and sellers, CCIL significantly reduces counterparty risk and enhances the overall stability and efficiency of the Indian financial system's settlement processes.
- 32. (A)** ALCO — Recommends Base Rate or MCLR of the bank to the Board.
The Asset-Liability Management Committee is a senior-level executive group primarily responsible for managing the bank's liquidity and interest rate risks. One of its key roles is recommending the base rate or the marginal cost of funds based lending rate to the Board. This ensures that the bank's pricing strategy remains aligned with its funding costs and profitability.
- 33. (A)** Only I is correct
Aggregated risk is a fundamental driver of an organization's capital needs. However, the total risk of a portfolio is not simply the sum of individual transaction risks. Due to the effects of diversification and varying correlations between different assets, the incremental risk added to a portfolio is typically less than the standalone risk of the individual transaction itself.
- 34. (B)** Counterparty risk
When a trader enters into a forward purchase contract to eliminate price uncertainty, they introduce counterparty risk. This risk arises from the possibility that the seller may fail to deliver the goods at the agreed future date. While price fluctuations are hedged, the trader now relies on the performance and financial stability of the other party involved.
- 35. (A)** I and II only
The Clearing Corporation of India acts as a central counterparty for several key financial market segments. These include the government securities segment, encompassing outright trades and various repo transactions. Additionally, CCIL provides clearing and settlement for the USD-INR and forex forward segments. However, it does not typically act as the central counterparty for equity derivatives.
- 36. (A)** Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Capital serves as a crucial buffer against potential financial losses in business. To maintain solvency, the minimum capital required must be sufficient

to cover the maximum loss that could reasonably arise from trading activities. Without adequate capital support, any significant loss could lead to bankruptcy, as the business would lack the necessary funds to absorb the impact.

- 37.** (A) Overestimation of loss on account of risks may result in underpricing.

Risks in a business must be accounted for as a regular cost of business. While underestimation of losses can result in lower profits and affected RAROC, overestimation of loss would actually lead to overpricing. Accurate pricing associated with potential risk ensures that the business remains competitive while properly factoring in the probability of loss associated with all risks.

- 38.** (C) Negative correlation

The reduction in overall portfolio risk when individual business cash flows move in opposite directions is caused by negative correlation. When some businesses experience decreased inflows while others see increases, the variations offset each other. This statistical relationship results in a total portfolio with lower variability and more stable net cash flows than any of the individual components.

- 39.** (C) To earn a risk premium for higher variability of cash flow.

Investment 2 has highly uncertain and fluctuating cash flows, making it riskier than the stable and predictable cash flows of Investment 1. Rational investors demand a higher return (14%) as compensation for this additional risk, known as a risk premium. In contrast, steady cash flows carry lower risk, so a lower return (12%) is acceptable.

- 40.** (C) I, III, and IV

Risk Adjusted Return on Capital is a superior performance metric because it incorporates the specific risks taken to generate returns. It allows for the direct comparison of different businesses with varying volatility profiles. By focusing on returns relative to allocated risk capital, RAROC ensures that high-return transactions are evaluated against the higher risks they might entail.

- 41.** (C) Lower than level 2 risk due to the effect of diversification

Extending credit to a large number of independent borrowers reduces the overall risk of a portfolio through diversification. Since the default of one borrower is not necessarily linked to another, the combined risk level is lower than the risk of any single individual account. This statistical effect ensures that the portfolio's total variability remains manageable and relatively predictable.

- 42.** (B) Risk preference is a corporate issue with guidance emanating from the top.

In an organization, risk preference is treated as a strategic corporate issue. Guidance on how much risk to take and which types of risk are acceptable flows from the top management downwards. This ensures that transaction-level decisions are aligned with the overall enterprise-wide risk appetite and strategic objectives, rather than being determined independently by individual business units.

- 43.** (D) Basis Risk

Basis risk occurs when there is a mismatch in the interest rate benchmarks of assets and liabilities. If a bank funds a loan linked to its marginal cost of funds based lending rate with a deposit linked to a different benchmark like the Treasury Bill rate, any non-parallel movement between the two indices will squeeze the margin. This happens because the income and cost are driven by different market parameters.

- 44.** (B) Deviation of a target variable due to unit movement of a parameter.

Sensitivity is a risk measurement tool that quantifies the change in a target variable resulting from a single unit movement in a specific market parameter. For instance, it might measure how much the value of a portfolio changes if interest rates move by one percent. It focuses on the direct impact of individual factors on the overall financial outcome.

- 45.** (B) 1, 2, 3, 4

Implementing Enterprise-Wide Risk Management follows a logical progression beginning with a review of the internal environment and risk culture. This is followed by a review of the objective-setting process and an assessment of existing risk-factor identification mechanisms.

prevailing market conditions and its predictive power is limited to scenarios where the market moves exactly as it has in the past. These drawbacks make it an incomplete tool for assessing complex, multi-factor market environments.

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income. This allows organizations to evaluate performance on a level playing field, ensuring that capital is allocated to areas that provide the best return relative to their risk.

55. (C) Cost of funds should correspond to the term of deployment.

A fundamental principle of pricing is that the cost of funds used in the calculation must correspond to the term of the funds' deployment. When a bank funds long-term assets with short-term liabilities, it exposes itself to margin compression if interest rates rise. Correct pricing must reflect the actual duration of the commitment to ensure financial sustainability and stability.

56. (C) Both I and II are correct

Risk and variability are intrinsically linked in financial outcomes. Lower risk levels are associated with reduced variability in net cash flows, meaning both the potential for high gains and severe losses is limited. Conversely, higher risk implies greater variability, offering both higher upside potential for profit and a significant downside potential for loss, reflecting the trade-off inherent in risk-taking.

57. (B) RBI instructed that benchmarks must be developed exclusively by FEDAI.

While the Reserve Bank of India has mandated linking new retail loans to external benchmarks, the instruction that these benchmarks must be developed exclusively by the Foreign Exchange Dealers' Association of India is incorrect. Benchmarks are typically administered and developed by specialized entities like Financial Benchmarks India Limited, ensuring transparency and reliability in the interest rate setting process for banks.

58. (D) Implicit Volatility

Implicit volatility is the metric used to capture the market's collective view on the likelihood of future price movements for a security. Unlike historical volatility, which looks at past data, implicit volatility is derived from current option prices. It serves as a forward-looking indicator, making it essential for pricing derivative contracts and assessing the expected future risk of an asset.

59. (D) I, II, III, IV, and V

Effective internal control processes within a bank involve a comprehensive set of monitoring activities. These include independent reviews by internal or external audits, relating risk to capital levels, and periodic reviews for accuracy. Additionally, identification of large exposures and concentrations, combined with rigorous stress testing and analysis of inputs, ensures that the bank's risk management framework remains robust and responsive.

60. (D) RBI Bond @ 6.50% — High-risk investment
While variations in sales volume and administrative costs represent risk elements in business, and equity trading is recognized as a high-risk activity, an investment in an RBI bond at six point five percent is not a high-risk investment. Sovereign bonds are considered zero-risk or low-risk assets because they provide guaranteed returns and principal safety, resulting in minimal cash flow variation.

61. (B) Adopting strategies that reduce uncertainties linked to risk elements.

Risk mitigation refers to the adoption of specific strategies and techniques aimed at reducing the uncertainties associated with various risk elements. This process involves identifying potential threats and taking proactive steps to minimize their impact or likelihood. Effective mitigation ensures that the organization can manage its downside exposure while maintaining its ability to achieve its strategic objectives within its risk appetite.

62. (A) Load the negative impact of the CRR contribution into the lending rates.

Banks are required to maintain a Cash Reserve Ratio with the Reserve Bank of India, which represents funds that do not earn any interest. To compensate for the lack of earnings on these deployable funds, banks must load the negative impact of the CRR contribution into their lending rates. This ensures that the final interest rate charged covers all regulatory costs.

63. (B) I, II, III, and V only

The Operational Risk Management Committee is responsible for ensuring the robustness of operational risk frameworks. Its functions include analyzing frauds within the bank

Finally, the organization formulates a detailed road map to guide the full implementation of the risk management plan across all levels.

46. (B) P-1, Q-4, R-2, S-3

Different risk measures target specific areas of banking operations. An interest rate gap measures the sensitivity of the banking book's margin, while duration assesses the trading book's sensitivity. Value at Risk serves as a downside risk measure, and volatility represents the standard deviation of variable values. These tools provide a comprehensive framework for monitoring and managing various risks.

47. (B) Early Italian

The word 'risk' finds its etymological roots in the early Italian term 'risicare', which translates to 'to dare'. This original meaning highlights the inherent nature of risk as a choice to engage in activities with uncertain outcomes. Over time, the concept has evolved into a sophisticated mathematical and managerial discipline used to assess and mitigate potential business losses.

48. (C) Both I and II are correct

Effective risk measurement primarily focuses on downside potential, which refers to the likelihood and magnitude of potential losses. This process ignores upside potential, as the primary goal is to ensure capital adequacy against adverse events. It requires modeling the probability distribution of these potential losses to provide a quantitative basis for risk assessment and subsequent decision-making within the organization.

49. (A) Value at Risk (VaR)

Value at Risk is a sophisticated downside risk measure widely utilized in the banking sector and by regulators. It integrates sensitivity and volatility to quantify the adverse effects of uncertainty on a portfolio. By providing a single number representing the potential maximum loss over a specific timeframe, VaR helps institutions manage their exposure and maintain appropriate capital buffers.

50. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

In financial pricing, the cost of funds must align with the specific term of their deployment. This

is because five-year funds typically have different costs than one-year funds, reflecting the time value of money and liquidity considerations. Ensuring this correspondence allows banks to maintain stable margins and accurately reflect the interest rate risk inherent in the transaction's duration.

51. (C) Enterprise Risk Management Framework

Banks have increasingly adopted the Enterprise Risk Management framework released by the Committee of Sponsoring Organizations of the Treadway Commission. This framework provides a comprehensive structure for managing risks beyond the requirements of Basel norms. It helps organizations identify, assess, and respond to various risks holistically, ensuring that risk management is integrated into the entity's overall strategy and operations.

52. (C) Risk is assessable uncertainty, while uncertainty is imprecise knowledge.

Risk is fundamentally different from uncertainty in terms of assessment and quantification. Risk represents a situation where uncertainty is assessable, allowing for the creation of a probability distribution of potential outcomes. In contrast, uncertainty involves imprecise knowledge about the future where probabilities cannot be reliably determined. Therefore, risk management focuses on converting unquantifiable uncertainty into manageable, assessable risk.

53. (D) Pricing requires risk content to be instrumental in evaluating exposure.

Measuring risk at the transaction level is critical because it directly informs the pricing of the exposure. Since every transaction carries specific risk content, it must be evaluated to ensure that the interest rate or fee charged provides an adequate return for the risk assumed. This granular assessment is essential for maintaining the overall profitability and stability of the portfolio.

54. (C) It compares businesses with different volatility of return profiles.

Risk Adjusted Return on Capital provides a sophisticated mechanism for comparing businesses that have different volatility and return profiles. Unlike traditional measures, it explicitly accounts for the risk taken to generate

and predictable, therefore requiring a relatively lower capital backup to support its operations and absorb potential losses.

- 72.** (D) Diversified portfolio items do not behave in a unidirectional manner.

Portfolio risk is typically less than the weighted average of the risks of its individual components because diversified items do not behave in a unidirectional manner. When one asset experiences a loss, another may remain stable or gain, offsetting the impact. This lack of perfect correlation reduces the overall variability and downside potential, making the portfolio safer than its individual parts.

- 73.** (A) Mid Office Group — Liquidity Risk

The risk management support structure involves specific groups for different risk types. While the Credit Risk Group handles credit risk and the Asset-Liability Group manages market risks like liquidity and interest rates, the Mid Office Group's primary role is monitoring treasury operations and market risk limits. Attributing only liquidity risk to the Mid Office Group is an incorrect representation of its functions.

- 74.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Any new product or deviation from established procedures can significantly change an organization's risk profile, requiring clearance at the corporate level. Decision-making is based on quantifying these risk-return characteristics, as risks taken at the individual transaction level directly impact the overall aggregated risk of the portfolio. This ensures that every exposure aligns with the bank's broader risk appetite and strategy.

- 75.** (C) 1, 2, 3, 4

In a transaction where a long-term loan is funded by a shorter-term deposit, risks emerge chronologically. Funding risk occurs first as the bank must secure initial funds. Time risk follows during the moratorium or repayment period. Basis risk arises when benchmarks fluctuate, and finally, gap or mismatch risk persists throughout the life of the transaction due to the underlying structural maturity differences.

- 76.** (C) It ensures survival during severely adverse business situations.

Risk management is critical because it ensures the survival of an organization during severely adverse business conditions. While it cannot eliminate all operational variations or guarantee profits, it provides the framework and capital buffers necessary to withstand extreme shocks. By managing downside potential, the organization protects itself from catastrophic failures, thereby securing its long-term operational continuity and overall financial stability.

- 77.** (C) Embedded Option Risk

When a borrower prepays a long-term loan earlier than expected, it creates a challenge for the bank to redeploy those funds at the same rate. This situation illustrates embedded option risk, which arises because the borrower has the right, but not the obligation, to change the transaction's cash flow. Such events can lead to reinvestment risk and affect the bank's profitability.

- 78.** (D) Risk multiplication

Enterprise Risk Management involves selecting from various strategic responses to manage identified threats. These typically include risk avoidance, which involves exiting activities; risk reduction, which minimizes impact; and risk transfer, which shifts risk to another party. However, risk multiplication is not a valid risk response, as the goal of the framework is to control and mitigate risk rather than increase it.

- 79.** (B) A structured process of identifying, prioritizing, and mitigating risks holistically.

Enterprise-Wide Risk Management is defined as a structured and comprehensive process used by an organization to identify, prioritize, and mitigate risks holistically. Unlike fragmented approaches, EWRM looks at the entire organization to understand how different risks interact. This process ensures that risk management is integrated into the entity's strategy, helping it achieve objectives while maintaining stability across all functional areas.

- 80.** (C) I, III, and IV

Sensitivity analysis has several limitations, including its focus on only one market parameter at a time without considering simultaneous changes in others. It is highly dependent on

and recommending measures to prevent their recurrence. Additionally, the committee clears new non-credit products, ensuring that operational risks are identified and managed. However, clearing new credit products typically falls under the purview of the Credit Risk Management Committee.

- 64.** (A) ROE is computed from financial statements and fully captures risks in the revenue model. Traditional measures like Return on Assets and Return on Equity have limitations because they do not fully capture the risks inherent in a business's revenue model. While ROE is computed from financial statements, it fails to reflect the volatility of returns or the specific risk taken. In contrast, RAROC provides a superior evaluation by adjusting returns for the level of risk assumed.
- 65.** (A) Avoiding damage to the entity's reputation and associated consequences. Beyond ensuring effective reporting and regulatory compliance, Enterprise Risk Management is critical for protecting an entity's reputation. By identifying and mitigating risks holistically, ERM helps prevent events that could damage the organization's public image and lead to severe financial or legal consequences. Safeguarding reputation is a vital outcome that ensures long-term survival and trust in the marketplace for any organization.
- 66.** (C) Higher variability in cash flow requires higher capital for losses. The relationship between risk and capital is direct; higher variability in net cash flows indicates a greater potential for significant losses. Consequently, businesses with high volatility require larger capital buffers to absorb these potential adverse movements. Conversely, lower variability implies more stable outcomes and reduced loss possibilities, allowing the business to operate safely with a relatively lower level of capital support.
- 67.** (A) P-2, Q-3, R-1, S-4
The risk management organization involves several layers of responsibility. The Board of Directors holds overall responsibility for risk management, while the Risk Management Committee ensures the robustness of

measurement models. Senior executives implement both risk and business policies, and the support group handles independent monitoring, measurement, and reporting. This structured approach ensures that risk management is integrated across the entire organization.

- 68.** (A) I and II only
The Risk Management Committee is a board-level subcommittee tasked with high-level oversight. Its responsibilities include setting guidelines for risk management and reporting, as well as ensuring that risk measurement models are robust and reliable. While it oversees policy and framework, real-time monitoring of specific areas like treasury operations is typically delegated to specialized support groups such as the Mid Office.
- 69.** (B) Losses can wipe out capital employed, resulting in bankruptcy.
In a trading business, a permanent decline in unit prices can lead to substantial financial losses. If these losses are not controlled through effective risk management, they can exceed the business's available capital, ultimately resulting in bankruptcy. Maintaining adequate capital support and implementing risk limits are essential to ensure the business can survive such adverse market movements without facing total failure.
- 70.** (D) Asset-Liability Committee (ALCO)
The Asset-Liability Committee is the senior-level executive sub-group responsible for managing the bank's balance sheet and margin. When the bank needs to revise its Marginal Cost of funds based Lending Rate to improve its Net Interest Margin, ALCO is the body that recommends these changes to the Board. This ensures that lending rates are aligned with funding costs and profitability.
- 71.** (D) A business with lower variation in net cash flow would be a business requiring higher capital backup.
The capital requirement of a business is determined by the risks associated with its revenue model. Higher risks and greater variations in net cash flow necessitate higher capital buffers and return expectations. Conversely, a business with lower variation in its cash flows is more stable

CHAPTER 12

Risks in Banking Business

Oct/Nov 2016

1. If Apex Bank engaged in providing specific structuring and customization to make large and risky corporate acquisitions feasible for these manufacturing firms, under which broad business subgroup would this activity be categorized?
- (A) Retail Banking
 - (B) Specialized Finance
 - (C) Payments and Settlement
 - (D) Retail Brokerage

May/June 2023

2. Identify the incorrectly matched pair regarding Market Risk components.
- (A) Interest Rate Risk component - Affects the price of interest rate instruments.
 - (B) Pricing Risk - Applies to commodities like gold held in the trading book.
 - (C) Counterparty Risk - Inability to conclude a large transaction near the current market price.
 - (D) Foreign Currency Risk - Arises from adverse exchange rate movements.

Oct/Nov 2012

3. How is Liquidity Risk defined in the context of banking business?
- (A) The inability to obtain funds to meet cash flow obligations at a reasonable rate.
 - (B) The potential of a bank borrower or counterparty failing to meet obligations.
 - (C) The inability to conclude a large transaction near the current market price.
 - (D) The risk of adverse deviations of the mark-to-market value of the trading portfolio.

May/June 2005

4. Consider the following statements:
- I. Yield curve risk is a type of basis risk that arises with respect to different maturity benchmarks to which liabilities and assets are linked.
 - II. In a floating interest rate scenario, any non-parallel movements in yield curves would

affect the Net Interest Income.

Which of the above statements is/are correct?

- (A) Both Statement I and Statement II are correct.
- (B) Both Statement I and Statement II are incorrect.
- (C) Statement I is correct, but Statement II is incorrect.
- (D) Statement I is incorrect, but Statement II is correct.

Oct/Nov 2020

5. What does Basis Risk refer to?
- (A) Holding assets and liabilities with different principal amounts, maturity dates, and contractual interest rate structures.
 - (B) The uncertainty with regard to the interest rate at which future periodic cash flows could be reinvested.
 - (C) The risk of adverse business decisions, improper implementation, or failure to meet long-term strategic goals.
 - (D) Different magnitude changes in the interest rates of various assets, liabilities, and off-balance sheet items.

May/June 2019

6. Consider the following statements:
- I. Contingent exposures like letters of credit may become fund-based exposures depending on the happening of certain events.
 - II. Derivatives held for hedging exposures under the trading book do not form part of the trading book.

Which of the above statements is/are correct?

- (A) Both Statement I and Statement II are correct.
- (B) Both Statement I and Statement II are incorrect.
- (C) Statement I is correct, but Statement II is incorrect.
- (D) Statement I is incorrect, but Statement II is correct.

- (A) I, II, III, and V
- (B) II, III, IV, and V
- (C) I, II, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2024

21. Identify the incorrect statement regarding Model Risk.
- (A) It is the gap between the value predicted through a model and the value actually observed.
 - (B) It can arise from ignoring one or more parameters for simplification.
 - (C) It can arise from incorrect assumptions which have become non-relevant.
 - (D) Validation of models must be carried out by the personnel who designed the model.

May/June 2018

22. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Choose the correct option to describe the relationship between these two statements.

Assertion (A): Yield curve risk is considered a type of basis risk in interest rate management.
Reason (R): Yield curve risk arises with respect to different maturity benchmarks to which liabilities and assets are linked, causing non-parallel movements.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2006

23. The term Market Risk applies to all of the following, EXCEPT:
- (A) Pricing risk for all assets including commodities like gold held in the trading book.
 - (B) The risk of borrower failure due to country-specific constraints and restrictions.
 - (C) That part of Interest Rate Risk which affects the price of interest rate instruments.
 - (D) Foreign Currency Risk.

May/June 2014

24. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Choose the correct option to describe the relationship between these two statements.

Assertion (A): Reputational risk is normally treated as an indirect risk for financial institutions.

Reason (R): Reputational risk exposes the institution to a decline in customer base because of the crystallization of credit, market, or operational risks.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2023

25. All of the following activities fall under the "Corporate Finance" business line, EXCEPT:

- (A) Prime Brokerage
- (B) Municipal/Government Finance
- (C) Merchant Banking
- (D) Advisory Services

May/June 2010

26. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Choose the correct option to describe the relationship between these two statements.

Assertion (A): Off-balance sheet exposures do not entail any cash outflow for the bank on the day such commitments are issued.

Reason (R): They are purely non-fund based exposures that become fund-based only if the customer fails to meet their obligation on the maturity date.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

IV. Derivatives like swaps and futures are examples of off-balance sheet market exposures.

Which combination is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, III, and IV

Oct/Nov 2022

15. Which statement correctly describes Strategic Risk?

- (A) It arises primarily from the failure of a bank borrower to meet their periodic repayment obligations.
- (B) It is defined as a core component of operational risk under the standard Basel framework.
- (C) It solely concerns the gap between model-predicted values and the actual observed values in the market.
- (D) A function of the compatibility of strategic goals and the resources deployed against those goals.

May/June 2013

16. Consider the following statements regarding Model Risk:

- I. It is defined as the gap between value predicted through a model and the value actually observed.
- II. Incorrect assumptions which have become non-relevant cause model risk.
- III. Model validation must be carried out by personnel deeply involved in the design to ensure accuracy.
- IV. Incorrect judgment in dealing with outliers can trigger model risk.

Which combination is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

Oct/Nov 2019

17. Which statement is correct regarding Physical risks associated with Climate Risk?

- (A) They arise from the process of adjustment towards a low-carbon economy.
- (B) They are categorized as acute risks like floods or chronic risks like rising sea levels.
- (C) They include the introduction of subsidies

to encourage the use of energy-efficient goods.

(D) They represent shifts in public sentiment of consumers and investors.

May/June 2021

18. Consider the following statements regarding Broad Risk Types:

- I. The banking book mostly attracts capital charge on credit risk and not on market risk.
- II. The trading book holds assets normally liquidated in the market after a certain period.
- III. Off-balance sheet items have no potential to become fund-based exposures.
- IV. Yield curve risk is classified as a type of basis risk.
- V. The trading book includes fixed income securities, equities, and foreign exchange holdings.

Which combination is correct?

- (A) I, II, III, and IV
- (B) II, III, IV, and V
- (C) I, II, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2007

19. Which of the following is an incorrect statement about the Trading Book?

- (A) It is completely immune to default or credit risk since trades are settled instantly.
- (B) Positions are liquidated in the market after holding the assets for a certain period.
- (C) The mark-to-market system is followed on a daily or periodic basis.
- (D) It mostly comprises fixed income securities, equities, and foreign exchange holdings.

May/June 2025

20. Consider the following statements regarding Operational and Climate Risk:

- I. Strategic risk deals with adverse business decisions and improper implementation.
- II. Reputational risk is normally treated as a direct financial risk.
- III. Acute physical risks in climate risk include floods and heatwaves.
- IV. Transition risks include climate-related mitigation policies and technological advances.
- V. Compliance risk is also called integrity risk.

Which combination is correct?

Oct/Nov 2010

7. Which type of capital charge is attracted by the assets and liabilities held in the banking book?
- Market risk and credit risk
 - Credit risk and not on market risk
 - Market risk and not on credit risk
 - Operational risk only

May/June 2024

8. Consider the following statements regarding Country Risk and Counterparty Risk:
- Counterparty risk happens in call money borrowing since it is purely unsecured.
 - Herstatt Risk is a widely known variant of country risk.
 - Country risk arises due to constraints or restrictions imposed by a country on which the borrower has no control.
- Which combination is correct?
- I and III only
 - I and II only
 - II and III only
 - I, II, and III

Oct/Nov 2015

9. Herstatt Risk is a well-known variant of which of the following risks?
- Counterparty Risk
 - Model Risk
 - Country Risk
 - Liquidity Risk

May/June 2008

10. Consider the following statements regarding Climate Risk:
- Physical risks can be acute, such as floods and heatwaves.
 - Transition risks arise from the process of adjustment towards a low-carbon economy.
 - Technological advances that increase the use of fossil fuels act as a major transition risk mitigation.
- Which combination is correct?
- II and III only
 - I and II only
 - I and III only
 - I, II, and III

Oct/Nov 2005

11. How does a bank face Net Interest Position Risk when market interest rates adjust downwards?
- When the bank has more earning assets than paying liabilities.

- When the bank holds more paying liabilities than earning assets.
- When the bank faces a surge in premature withdrawal of deposits.
- When the bank relies heavily on foreign currency borrowings.

May/June 2017

12. Consider the following statements regarding Interest Rate Risk (IRR):
- IRR refers to the potential adverse impact on Net Interest Income, Net Interest Margin, or Market Value of Equity.
 - It only impacts the earnings of the bank and has no impact on the economic value of assets.
 - The risk of different asset and liability interest rates changing in different magnitudes is Basis Risk.
 - Reinvestment risk arises due to uncertainty in the interest rate for future cash flows.
- Which combination of statements is correct?
- I, II, and III
 - II, III, and IV
 - I, III, and IV
 - I, II, III, and IV

Oct/Nov 2025

13. Why is Reputational Risk normally treated as an indirect risk for a bank?
- It relies on highly complex pricing models that fail unpredictably under extreme market stress scenarios.
 - It stems from the crystallization of credit, market, or operational risks within the organization.
 - It is strictly defined as a component of foreign exchange fluctuations and currency devaluation.
 - It only arises when regulatory bodies impose formal compliance sanctions or significant financial fines.

May/June 2011

14. Consider the following statements regarding Off-Balance Sheet Exposures:
- They are non-fund based exposures or credit facilities.
 - They imply an immediate cash outflow on the day the commitment is issued.
 - They expose the bank to liquidity, interest rate, market, default, and operational risks.

Oct/Nov 2011

27. Which of the following is the most appropriate description of Reinvestment Risk?
- (A) Uncertainty regarding interest rates at which future cash flows could be reinvested.
 - (B) The risk of adverse deviations in the mark-to-market value of the trading portfolio assets.
 - (C) The risk arising from holding assets and liabilities with different interest repricing dates.
 - (D) The risk of premature withdrawal of term deposits due to market interest rate fluctuations.

May/June 2020

28. Which statement is correct regarding Physical risks associated with Climate Risk?
- (A) They arise from the process of adjustment towards a low-carbon economy.
 - (B) They are categorized as acute risks like floods or chronic risks like rising sea levels.
 - (C) They include the introduction of subsidies to encourage the use of energy-efficient goods.
 - (D) They represent shifts in public sentiment of consumers and investors.

Oct/Nov 2008

29. Which scenario most appropriately illustrates Embedded Option Risk?
- (A) A bank utilizes a simplified pricing model for its derivative products causing estimation gaps.
 - (B) A retail customer prepays their housing loan following a significant drop in market interest rates.
 - (C) A corporate borrower default due to restrictions imposed by its home country.
 - (D) A bank faces a liquidity shortfall due to sudden un-renewed wholesale deposits.

May/June 2012

30. The portfolio held by XYZ Bank on its own account for capitalizing on short-term price movements is classified as:
- (A) The Banking Book
 - (B) The Commercial Book
 - (C) The Trading Book
 - (D) The Off-Balance Sheet Portfolio

Oct/Nov 2018

31. Which of the following best defines Compliance Risk?
- (A) The risk of a gap between values predicted by internal models and the actual observed market value.
 - (B) The risk arising from fraudulent transactions executed by external cyber attackers and hackers.
 - (C) The risk that an organization's high-level business strategies are improperly or poorly implemented.
 - (D) Financial or reputation loss resulting from failure to comply with laws and codes of conduct.

May/June 2007

32. Based on standard regulatory guidelines, how quickly must XYZ Bank sell the securities classified under the "Held for Trading" category?
- (A) Within 30 days
 - (B) Within 60 days
 - (C) Within 90 days
 - (D) Within 120 days

Oct/Nov 2014

33. Arrange the following regulatory and operational timeframes from the shortest to the longest duration:
- I. The frequency of bi-monthly repo rate changes.
 - II. The ninety-day regulatory holding limit for 'Held for Trading' securities.
 - III. The six-month repricing period of a bank liability.
 - IV. The two-year maturity period of a fixed-rate asset.
- (A) I, III, II, IV
 - (B) I, II, III, IV
 - (C) II, I, IV, III
 - (D) III, II, I, IV

May/June 2006

34. The risk arising from retail borrowers delaying their EMI payments and performing assets turning non-performing is termed as:
- (A) Call Risk
 - (B) Reinvestment Risk
 - (C) Time Risk
 - (D) Funding Risk

Oct/Nov 2023

63. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Choose the correct option to describe the relationship between these two statements.

Assertion (A): The assets and liabilities held in the banking book attract a capital charge on market risk rather than credit risk.

Reason (R): The banking book is not open to the market and its assets are normally held until maturity.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2025

64. The scope of operational risk is very wide. Which of the following is NOT covered under the definition of operational risk?

- (A) Model risk
- (B) Fraud risk
- (C) Legal risk
- (D) Strategic risk

Oct/Nov 2024

65. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Choose the correct option to describe the relationship between these two statements.

Assertion (A): The validation of models must be carried out by the personnel who are actively involved in the design of the model.

Reason (R): Model validation is strictly conducted through back testing to identify the gap between predicted and observed values.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2014

66. Transition risk drivers under Climate Risk can be categorized into all of the following, EXCEPT:

- (A) Climate related mitigation policies.
- (B) Technological advances reducing GHG emissions.
- (C) Ocean acidification and extreme weather variability.
- (D) Shifts in public sentiment of consumers and investors.

Oct/Nov 2006

67. Based on the scenario, the bank's strategy of funding a repo-linked loan using fixed-rate deposits primarily exposes it to which of the following risks?

- (A) Basis Risk
- (B) Yield Curve Risk
- (C) Embedded Option Risk
- (D) Reinvestment Risk

May/June 2010

68. Which of the following best describes the key driver in managing all the business lines in a bank?

- (A) Minimizing compliance risk across all geographical locations.
- (B) Ensuring all off-balance sheet items remain strictly non-fund based.
- (C) Liquidating all trading book assets within a 30-day window.
- (D) Enhancing risk-adjusted expected return.

Oct/Nov 2011

69. If the market interest rate causes the Net Interest Income (NII) to expand due to favorable repo rate adjustments, which of the following statements correctly describes the bank's position?

- (A) The bank has completely eliminated gap risk.
- (B) The bank must reclassify the assets into the trading book.
- (C) The basis has moved against the bank.
- (D) The bank has experienced favorable basis shifts.

May/June 2020

70. What is the most appropriate description of Call Risk in liquidity management?

- (A) It arises when performing assets turn into non-performing assets causing fund inflows to stop.
- (B) It arises from the unexpected withdrawal of

- (B) Recording revenue before receipt of payment or expenses before actual cash outflow.
- (C) It involves a strict daily mark-to-market exercise for all bank-held assets and liabilities.
- (D) It is a specialized accounting framework restricted solely to high-volume trading book exposures.

Oct/Nov 2022

43. Consider the following statements:

- I. The banking book includes advances, deposits, and borrowings which are subjected to a strict daily mark-to-market exercise.
- II. The trading book is mainly exposed to market risk, market liquidity risk, default or credit risk, and operational risk.

Which of the above statements is/are correct?

- (A) Both Statement I and Statement II are correct.
- (B) Both Statement I and Statement II are incorrect.
- (C) Statement I is correct, but Statement II is incorrect.
- (D) Statement I is incorrect, but Statement II is correct.

May/June 2023

44. Which of the following defines Market Risk?

- (A) The risk of legal or regulatory sanction resulting from failure to comply with established laws or standards.
- (B) The risk that interest rates of different assets and liabilities may change in different magnitudes and timelines.
- (C) Adverse deviations in the mark-to-market value of the trading portfolio during the period of holding.
- (D) The inability to obtain necessary funds at a reasonable rate to meet upcoming cash flow obligations.

Oct/Nov 2025

45. Consider the following statements:

- I. Reputational risk is normally treated as a direct operational risk component in standard banking definitions.
- II. Strategic risk calls for evaluating whether there is a gap between the strategy aimed at and the strategy implemented.

Which of the above statements is/are correct?

- (A) Both Statement I and Statement II are correct.
- (B) Both Statement I and Statement II are incorrect.
- (C) Statement I is correct, but Statement II is incorrect.
- (D) Statement I is incorrect, but Statement II is correct.

May/June 2018

46. According to standard regulatory guidelines, within what maximum period are securities classified under the 'Held for Trading' category expected to be sold?

- (A) 30 days
- (B) 60 days
- (C) 90 days
- (D) 120 days

Oct/Nov 2009

47. Consider the following statements regarding the Trading Book:

- I. The mark-to-market system is followed and the difference is taken to the profit and loss account.
- II. It mostly comprises fixed income securities, equities, and commodities held on the bank's own account.
- III. Positions are normally held until maturity to avoid market liquidity risk.

Which combination is correct?

- (A) II and III only
- (B) I and III only
- (C) I, II, and III
- (D) I and II only

May/June 2005

48. The scope of operational risk is very wide. Under standard banking definitions, which of the following risks are strictly excluded?

- (A) Fraud risk and Compliance risk
- (B) Transaction risk and Legal risk
- (C) Model risk and Communication risk
- (D) Strategic risk and Reputation risk

Oct/Nov 2012

49. Consider the following statements regarding Operational Risk components:

- I. Transaction risk arises from both internal and external fraud and failed business processes.
- II. Compliance risk is also called integrity risk

since reputation is linked to fair dealing.

III. Model risk is defined as the risk of losses resulting from adverse public opinion.

Which combination is correct?

- (A) I and III only
- (B) I and II only
- (C) II and III only
- (D) I, II, and III

May/June 2019

50. Why is the banking book primarily NOT exposed to market risk?

- (A) Assets are traded daily to recognize short-term profit.
- (B) It consists of derivatives that are perfectly hedged against price movements.
- (C) It is not open to the market and assets are normally held until maturity.
- (D) Assets are marked-to-market periodically mitigating price fluctuations.

Oct/Nov 2010

51. Consider the following statements regarding Liquidity Risk:

- I. Funding Risk arises from the need to replace net outflows due to premature closure of term deposits.
- II. Time Risk arises from the crystallization of contingent liabilities on due dates.
- III. Call Risk may arise when a bank is unable to undertake profitable business opportunities when they arise.

Which combination is correct?

- (A) I and III only
- (B) I and II only
- (C) II and III only
- (D) I, II, and III

May/June 2024

52. Which risk arises from holding assets, liabilities, and off-balance sheet items with different principal amounts, maturity dates, or repricing dates?

- (A) Model Risk
- (B) Reinvestment Risk
- (C) Embedded Option Risk
- (D) Gap or Mismatch Risk

Oct/Nov 2015

53. Consider the following statements regarding the Accrual System:

- I. Revenue earned is recognized regardless of

when cash transactions have occurred.

II. Expenses are recorded as incurred before the entity has paid for them.

III. It is primarily applied to the trading book investments.

IV. All assets and liabilities in the banking book are subjected to this system.

Which combination is correct?

- (A) I, III, and IV
- (B) II, III, and IV
- (C) I, II, and III
- (D) I, II, and IV

May/June 2008

54. Which of the following statements is correct regarding off-balance sheet exposures?

- (A) They require an immediate and significant cash outflow from the bank on the day commitments are issued.
- (B) They are categorized under the banking book and are never allowed to be shifted to the trading book.
- (C) Non-fund based exposures that become fund-based upon the occurrence of certain contingent events.
- (D) They are completely immune to common risks like liquidity shortfalls, market volatility, and credit defaults.

Oct/Nov 2005

55. Consider the following statements regarding Market Risk and Forex Risk:

- I. Forex risk is the risk of losses due to adverse exchange rate movements during an open position.
- II. In the long term, if the domestic currency depreciates, importers are heavily impacted.
- III. Market risk includes pricing risk for commodities like gold held in the trading book.
- IV. Banks are permitted to take large trading positions in commodities to hedge market risk in certain regulatory environments.

Which combination is correct?

- (A) II, III, and IV
- (B) I, II, and III
- (C) I, III, and IV
- (D) I, II, and IV

May/June 2017

56. Which of the following accurately describes Time Risk?

- (A) The need to compensate for non-receipt of expected inflows of funds, such as unpaid EMIs.
- (B) The need to replace net outflows due to the unanticipated and sudden withdrawal of retail deposits.
- (C) The crystallization of contingent liabilities when customers fail to meet their contractual commitments.
- (D) A specialized type of market risk resulting from short-term interest rate volatility and price shifts.

Oct/Nov 2014

57. Consider the following statements regarding the business lines and subgroups in banking:
- I. Mergers and acquisitions are an activity under Corporate Finance.
 - II. Market making and proprietary positions belong to Trading and Sales.
 - III. Retail lending and deposits are exclusive to Commercial Banking.
 - IV. Escrow and depository receipts fall under Agency Services.
 - V. Discretionary Fund Management is a subgroup of Asset Management.
- Which combination is correct?
- (A) I, II, IV, and V
 - (B) I, III, IV, and V
 - (C) II, III, IV, and V
 - (D) I, II, III, and IV

May/June 2011

58. Identify the incorrect statement regarding the characteristics of the Banking Book.
- (A) They are normally held until maturity.
 - (B) They are subjected to a strict daily mark-to-market (MTM) exercise.
 - (C) The accrual system of accounting is applied to them.
 - (D) They attract a capital charge on credit risk and not on market risk.

Oct/Nov 2007

59. Consider the following statements regarding Interest Rate Risk types:
- I. Gap risk arises due to holding items with different principal amounts or repricing dates.
 - II. Basis risk happens when rates on assets and liabilities change in different magnitudes.
 - III. Embedded option risk represents the

uncertainty of reinvestment rates for future cash flows.

- IV. Net interest position risk occurs when a bank has more earning assets than paying liabilities and rates adjust downwards.
- V. Yield curve risk arises due to non-parallel movements in yield curves.

Which combination is correct?

- (A) I, II, IV, and V
- (B) I, III, IV, and V
- (C) I, II, III, and V
- (D) II, III, IV, and V

May/June 2013

60. Which of the following statements about Operational Risk is incorrect?
- (A) Transaction risk arises from internal and external fraud and failed business processes.
 - (B) Compliance risk is also called integrity risk.
 - (C) Standard definitions strictly include strategic risk and reputation risk.
 - (D) It includes risks arising from inadequate internal processes, people, and systems.

Oct/Nov 2019

61. Consider the following statements regarding Default and Credit Risk:
- I. Credit risk is the potential that a borrower fails to meet agreed terms.
 - II. Loans and corporate bonds are the most obvious sources of credit risk.
 - III. Counterparty risk is viewed as a transient financial risk associated with trading.
 - IV. Herstatt Risk is a variant of country risk.
 - V. Country risk involves non-performance due to restrictions imposed by a country.

Which combination is correct?

- (A) II, III, IV, and V
- (B) I, II, III, and V
- (C) I, II, IV, and V
- (D) I, III, IV, and V

May/June 2021

62. All of the following are reasons for Model Risk usually arising, EXCEPT:
- (A) Incorrect assumptions or assumptions which have become non-relevant.
 - (B) Errors of statistical techniques or insufficient data points.
 - (C) Strict adherence to accurate parameters without any simplification.
 - (D) Incorrect judgment in dealing with outliers.

Oct/Nov 2017

35. Match the items in List I with the appropriate items in List II:

List I: (Forms of Interest Rate Risk)

- P. Gap Risk
- Q. Basis Risk
- R. Yield Curve Risk
- S. Embedded Option Risk

List II: (Triggers)

- 1. Non-parallel movements in yield curves
- 2. Different magnitude of rate changes
- 3. Premature withdrawal of term deposits
- 4. Different repricing dates.

- (A) P-4, Q-2, R-1, S-3
- (B) P-2, Q-3, R-1, S-4
- (C) P-1, Q-4, R-2, S-3
- (D) P-3, Q-1, R-4, S-2

May/June 2009

36. The massive deviation between the predicted values and the actual observed values in FinTech Bank's portfolio is termed as:

- (A) System Risk
- (B) Transaction Risk
- (C) Compliance Risk
- (D) Model Risk

Oct/Nov 2021

37. Match the items in List I with the appropriate items in List II:

List I: (Banking Concepts)

- P. Banking Book
- Q. Trading Book
- R. Off-Balance Sheet
- S. Pricing Models

List II: (Characteristics)

- 1. Mark-to-Market system is applied daily
- 2. Subject to back testing
- 3. Attracts capital charge on credit risk and not on market risk
- 4. Non-fund based credit facilities.

- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-4, Q-2, R-3, S-1
- (D) P-3, Q-1, R-4, S-2

May/June 2022

38. To mitigate this risk in the future, the bank decides to enforce a validation process through back testing. Who must carry out this validation?
- (A) The regulators overseeing the bank's trading activities.

- (B) The quantitative team that designed the model.
- (C) Personnel who are not involved in the design of the model.
- (D) External clients whose portfolios are managed by the model.

Oct/Nov 2009

39. Which of the following pairs of Liquidity Risk types and their causes is correctly matched?

- (A) Funding Risk - Arises due to crystallization of contingent liabilities.
- (B) Time Risk - Arises from the need to compensate for non-receipt of expected inflows of funds.
- (C) Call Risk - Arises from unanticipated withdrawal of wholesale deposits.
- (D) Reinvestment Risk - Arises from holding assets with different principal amounts.

May/June 2015

40. The downgrade of credit ratings for Apex Bank's carbon-heavy clients due to the introduction of new strict climate-related regulations is classified under:

- (A) Mitigation policies
- (B) Acute physical risks
- (C) Technological advances
- (D) Shifts in public sentiment

Oct/Nov 2013

41. Which of the following pairs of specific risks and their descriptions is incorrectly matched?

- (A) Net Interest Position Risk - Bank holds more paying liabilities than earning assets and market rates adjust upwards.
- (B) Embedded Option Risk - Premature withdrawal of term deposits.
- (C) Yield Curve Risk - Non-parallel movements in yield curves.
- (D) Basis Risk - Interest rate of different items changing in different magnitude.

May/June 2016

42. Which of the following statements describes the financial accounting method that allows an entity to record revenue before receiving payment for goods or services sold, or expenses as incurred before payment?

- (A) It recognizes revenue exclusively when physical cash transactions have been finalized between parties.

retail term deposits before maturity.

- (C) It arises due to the crystallization of contingent liabilities when customers do not meet commitments.
- (D) It arises from the inability to sell a corporate bond without causing an adverse price movement.

Oct/Nov 2008

71. The difficulty XYZ Bank faces in selling the corporate bonds due to lower trading volume without triggering an adverse price movement is precisely defined as:
- (A) Foreign Currency Risk
- (B) Market Liquidity Risk
- (C) Reinvestment Risk
- (D) Counterparty Risk

May/June 2012

72. Arrange the following events in the logical sequence of an off-balance sheet exposure crystallizing into a fund-based exposure:
- I. The customer fails to meet their obligation on the due date.
- II. The bank issues a backup credit line or letter of credit.
- III. The bank meets or funds the obligation.
- IV. The contingent due date or maturity date arrives.
- (A) II, IV, I, III
- (B) IV, II, III, I
- (C) II, I, IV, III
- (D) I, III, II, IV

Oct/Nov 2018

73. The unanticipated non-renewal of wholesale term deposits by institutional investors exposes Global Bank Ltd. to which specific risk?
- (A) Funding Risk
- (B) Time-based Risk
- (C) Call-related Risk
- (D) Gap-based Risk

May/June 2007

74. Match the items in List I with the appropriate items in List II:
- List I: (Business Lines)
- P. Asset Management
- Q. Retail Brokerage
- R. Agency Services
- S. Trading and Sales
- List II: (Sub-groups)

1. Custody
2. Non-Discretionary Fund Management
3. Market making
4. Execution and full service.

- (A) P-1, Q-2, R-3, S-4
- (B) P-2, Q-4, R-1, S-3
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-3, R-2, S-1

Oct/Nov 2016

75. The crystallization of the contingent liabilities due to corporate clients failing to meet their commitments represents which type of risk for the bank?
- (A) Call Risk
- (B) Time Risk
- (C) Basis Risk
- (D) Embedded Option Risk

May/June 2006

76. Match the items in List I with the appropriate items in List II:
- List I: (Specific Banking Risks)
- P. Fraud Risk
- Q. Herstatt Risk
- R. Foreign Currency Risk
- S. Call Risk
- List II: (Broad Categories)
1. Credit Risk
 2. Liquidity Risk
 3. Operational Risk
 4. Market Risk
- (A) P-1, Q-4, R-2, S-3
- (B) P-4, Q-2, R-3, S-1
- (C) P-3, Q-1, R-4, S-2
- (D) P-2, Q-3, R-1, S-4

Oct/Nov 2017

77. Which of the following was a primary reason for the materialization of the aforementioned risk in FinTech Bank's scenario?
- (A) Errors of statistical techniques.
- (B) Ignoring one or more parameters for simplification.
- (C) Incorrect judgment in dealing with outliers.
- (D) Total failure of internal communication systems.

May/June 2009

78. Match the items in List I with the appropriate items in List II:
- List I: (Climate Risk Elements)

NODIA

9. (A) Counterparty Risk

Herstatt risk is a well-known form of settlement risk occurring when one party in a foreign exchange transaction pays their currency but does not receive the other currency. This risk falls under the broader category of counterparty risk because it involves a failure by the counterparty to complete their contractual obligation. It highlights the dangers in cross-border settlement systems.

10. (B) I and II only

Physical climate risks manifest through acute events like floods or chronic changes like rising sea levels. Transition risks arise as society shifts toward a low-carbon economy through policy changes and new technologies. However, technological advancements that increase fossil fuel reliance would exacerbate transition risks rather than mitigate them, as global regulations increasingly favor sustainable energy alternatives over traditional carbon.

11. (A) When the bank has more earning assets than paying liabilities.

Net Interest Position Risk affects a bank when its assets and liabilities are mismatched in volume. If a bank holds more earning assets than paying liabilities, a downward adjustment in market interest rates reduces the income generated from assets more than it reduces the interest expense on liabilities. This scenario leads to a contraction of the bank's total net interest income.

12. (C) I, III, and IV

Interest Rate Risk involves potential threats to a bank's net interest income and the economic value of its assets. Basis risk describes the variation in magnitudes of rate changes across different financial instruments. Reinvestment risk specifically addresses the uncertainty of rates available for future cash flows. However, IRR definitely impacts the economic value of assets, making the second statement incorrect.

13. (B) It stems from the crystallization of credit, market, or operational risks within the organization.

Reputational risk is often considered a secondary or indirect consequence because it typically emerges after a primary risk event occurs. For example, a major credit default or a high-profile

operational failure can damage public trust and brand image. Consequently, managing primary financial and operational risks is the most effective way for a bank to safeguard its reputation among its stakeholders.

14. (C) I, III, and IV

Off-balance sheet exposures represent non-fund based commitments like guarantees and derivatives that do not involve immediate cash outflows. While they do not require funding upfront, they expose banks to various risks, including credit and market volatility. If certain contingent events occur, these exposures can convert into fund-based liabilities, requiring the bank to provide actual liquidity to settle obligations.

15. (D) A function of the compatibility of strategic goals and the resources deployed against those goals.

Strategic risk involves the potential for losses arising from adverse business decisions or the poor implementation of long-term goals. It assesses whether a bank's high-level objectives align with the resources and market environment available to it. Unlike operational or credit risks, strategic risk focuses on the viability of the institution's business model and its ability to adapt.

16. (D) I, II, and IV

Model risk occurs when there is a significant discrepancy between a model's predicted outcomes and actual market results. This often stems from outdated assumptions, simplified parameters, or poor handling of statistical outliers. To maintain objectivity, model validation should be conducted by independent personnel who were not involved in the original design process, ensuring that any inherent flaws are identified.

17. (B) They are categorized as acute risks like floods or chronic risks like rising sea levels.

Physical risks in the context of climate change are divided into acute and chronic categories. Acute risks involve sudden, severe weather events such as floods, heatwaves, or hurricanes that cause immediate damage. Chronic risks refer to long-term environmental shifts, such as rising sea levels or persistent temperature increases, which

ANSWERS

1. (B) Specialized Finance
Specialized finance involves complex structuring and customization to support large-scale corporate activities like acquisitions. It differs from standard retail or commercial banking by focusing on bespoke financial solutions for high-stakes business transformations. This subgroup ensures that risky corporate maneuvers remain feasible through tailored capital structures and expert financial engineering to meet specific corporate needs.
 2. (C) Counterparty Risk - Inability to conclude a large transaction near the current market price.
Market liquidity risk describes the inability to settle a large transaction without significantly affecting the market price. In contrast, counterparty risk refers to the possibility that a party in a financial contract fails to fulfill their contractual obligations. This distinction is crucial because liquidity risk pertains to market depth, whereas counterparty risk focuses on the potential for default by another party.
 3. (A) The inability to obtain funds to meet cash flow obligations at a reasonable rate.
Liquidity risk is fundamentally the danger that a bank cannot meet its maturing financial obligations as they become due. This occurs when an institution is unable to generate sufficient cash or borrow funds at a sustainable cost. Effective management of this risk ensures the bank maintains enough liquid assets to cover both planned and unexpected cash outflows without incurring excessive costs.
 4. (A) Both Statement I and Statement II are correct.
Yield curve risk is a specific form of basis risk that occurs when different maturity benchmarks for assets and liabilities do not move in parallel. Such non-parallel shifts in the yield curve can significantly alter the net interest income of a bank. Monitoring these movements is essential for banks to protect their earnings against fluctuations in interest rates across various tenors.
 5. (D) Different magnitude changes in the interest rates of various assets, liabilities, and off-balance sheet items.
Basis risk describes the uncertainty resulting from interest rate changes that affect assets, liabilities, and off-balance sheet instruments in varying magnitudes. Even if the underlying interest rates for these items are linked to different benchmarks, they may not move in perfect correlation. This lack of synchronization can lead to unforeseen and significant fluctuations in a bank's net interest margins.
 6. (C) Statement I is correct, but Statement II is incorrect.
Contingent exposures, such as letters of credit, represent potential fund-based liabilities that materialize only under specific conditions. While these are often non-fund based initially, they require capital. Conversely, derivatives held for hedging within the trading book remain part of that book. This ensures that all market-sensitive positions are properly accounted for under standard market risk capital requirements.
 7. (B) Credit risk and not on market risk.
The banking book primarily contains assets like loans and advances that are intended to be held until maturity rather than traded. Consequently, these positions are subjected to capital charges for credit risk based on the likelihood of borrower default. Since they are not frequently revalued at market prices, they generally do not attract a market risk capital charge.
- (A) I and III only
Counterparty risk is prevalent in unsecured transactions like call money, where the lender faces the risk of the borrower failing to repay. Country risk arises when government-imposed restrictions prevent a borrower from fulfilling their obligations, regardless of their own financial health. However, Herstatt risk is specifically a variant of settlement risk within counterparty risk, not a form of country risk.

- P. Acute physical risks
- Q. Chronic physical risks
- R. Mitigation policies
- S. Technological advances

List II: (Characteristics)

- 1. Rising sea levels and ocean acidification
- 2. Downgrade in credit ratings due to regulations
- 3. Floods and heatwaves
- 4. Increased use of non-fossil fuels.

(A) P-1, Q-4, R-3, S-2

(B) P-2, Q-3, R-1, S-4

(C) P-3, Q-1, R-2, S-4

(D) P-4, Q-2, R-1, S-3

Oct/Nov 2021

79. The severe property damage to coastal manufacturing facilities resulting from rising sea levels and extreme weather variability is an example of which specific type of risk channel?
- (A) Transaction Risk
 - (B) Strategic Risk
 - (C) Transition Risks
 - (D) Physical Risks

May/June 2022

80. Which of the following pairs of Business Lines and Activities is correctly matched?
- (A) Payment and Settlement - Escrow and depository receipts.
 - (B) Retail Banking - Factoring and leasing.
 - (C) Corporate Finance - Fixed income and foreign exchanges.
 - (D) Commercial Banking - Project finance and trade finance.

gradually impact the value of assets and business viability.

18. (C) I, II, IV, and V

The banking book primarily focuses on credit risk for assets held to maturity, while the trading book manages assets like equities and forex intended for short-term profit. Yield curve risk is a recognized subset of basis risk. Importantly, off-balance sheet items have a clear potential to become fund-based exposures if contingent conditions are met, contradicting the third listed statement.

19. (A) It is completely immune to default or credit risk since trades are settled instantly.

While the trading book is primarily associated with market risk, it is not immune to credit or default risk. Instruments held in the trading book, such as corporate bonds, carry the risk that the issuer might default before the position is liquidated. Therefore, banks must account for potential defaults alongside market price fluctuations when managing their trading book portfolios and capital.

20. (D) I, III, IV, and V

Strategic risk pertains to business decisions, while compliance risk is often referred to as integrity risk. Climate risks include acute physical events like floods and transition risks such as policy changes. However, reputational risk is typically categorized as an indirect risk because it usually follows the materialization of other risks, rather than being a direct standalone financial risk for the institution.

21. (D) Validation of models must be carried out by the personnel who designed the model.

Model risk involves discrepancies between predicted and actual values, often due to simplification or outdated assumptions. For effective risk management, the validation process must be independent. Personnel involved in designing a model may have inherent biases regarding its flaws. Therefore, independent reviewers are required to verify the model's accuracy through back testing and other rigorous analytical methods to ensure reliability.

22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Yield curve risk is indeed a form of basis risk because it arises from non-parallel movements in interest rates across different maturities. When the yield curve shifts in a non-uniform manner, it affects assets and liabilities differently based on their specific tenors. This relationship explains why yield curve movements are a critical component of managing a bank's overall interest rate sensitivity.

23. (B) The risk of borrower failure due to country-specific constraints and restrictions.

Market risk encompasses fluctuations in asset prices, interest rates, and foreign exchange rates. This includes pricing risks for commodities like gold and the impact of interest rate changes on trading instruments. However, the risk that a borrower cannot pay due to national restrictions is defined as country risk. Country risk is a component of credit risk, not market risk.

24. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Reputational risk is classified as an indirect risk because it typically manifests as a consequence of other risk failures. When a bank experiences significant credit defaults, market losses, or operational scandals, public perception turns negative. This loss of trust leads to a declining customer base and financial damage, illustrating why reputation depends heavily on the successful management of primary risk categories.

25. (A) Prime Brokerage

The Corporate Finance business line includes high-level advisory services, merchant banking, and government finance. These activities involve capital raising and strategic financial structuring for large entities. In contrast, prime brokerage is a specialized suite of services typically offered to hedge funds and large institutional investors, falling under the Trading and Sales business line rather than standard corporate finance activities.

- 26.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Off-balance sheet exposures, such as guarantees or letters of credit, are non-fund based at inception and do not require immediate cash outflows. They represent contingent liabilities that only require funding if a specific event, like a customer default, occurs. This structural characteristic defines them as off-balance sheet until they are triggered, at which point they convert into actual fund-based bank exposures.

- 27.** (A) Uncertainty regarding interest rates at which future cash flows could be reinvested.

Reinvestment risk focuses on the potential for future interest rates to be lower than the rates currently earned on assets. This uncertainty affects the total return on an investment because periodic cash flows, like interest payments, may have to be reinvested at less favorable market rates. Managing this risk is vital for banks to maintain consistent profitability over the long term.

- 28.** (B) They are categorized as acute risks like floods or chronic risks like rising sea levels.

Physical climate risks are distinguished by their duration and impact patterns. Acute risks are sudden and disruptive events, such as severe storms or floods, that cause immediate physical damage to infrastructure. Chronic risks involve gradual environmental changes, such as rising global temperatures or sea levels, which slowly erode asset values and increase operational costs for businesses over several decades.

- 29.** (B) A retail customer prepays their housing loan following a significant drop in market interest rates.

Embedded option risk occurs when bank products include features that allow customers to change the timing or amount of cash flows. A classic example is a borrower choosing to prepay a loan when market rates fall to refinance at a lower cost. This action deprives the bank of expected high-interest income, creating a mismatch that the institution must carefully manage.

- 30.** (C) The Trading Book

The trading book consists of financial instruments held by a bank with the intent of

profiting from short-term price fluctuations. These assets, which include stocks, bonds, and currencies, are managed actively and are subject to frequent valuation changes. Unlike the banking book, where assets are held for long-term interest income, the trading book emphasizes marketability and immediate realization of gains.

- 31.** (D) Financial or reputation loss resulting from failure to comply with laws and codes of conduct. Compliance risk, often referred to as integrity risk, arises when a financial institution fails to adhere to established laws, regulations, or ethical standards. Such failures can lead to significant legal penalties, regulatory fines, and damage to the bank's reputation. Maintaining a strong compliance framework is essential for ensuring that the bank operates within the legal boundaries of the financial system.

- 32.** (C) Within 90 days

Regulatory guidelines typically specify that securities classified under the "Held for Trading" category should be sold within a short timeframe, usually ninety days. This requirement reflects the nature of these assets as short-term investments intended for quick resale to capture market price movements. Adherence to this limit ensures that the trading book remains liquid and focused on active market participation.

- 33.** (B) I, II, III, IV

Sequencing financial timeframes requires comparing standard cycles. The bi-monthly repo rate changes occur roughly every sixty days. The regulatory limit for 'Held for Trading' securities is ninety days. A six-month repricing period equals one hundred and eighty days. Finally, a two-year maturity period spans seven hundred and thirty days. Therefore, the logical order from shortest to longest duration follows this sequence.

- 34.** (C) Time Risk

Time risk is a specific form of liquidity risk that occurs when expected cash inflows are delayed. When retail borrowers fail to pay their EMIs on time, the bank does not receive the funds it planned to use for its own obligations. This mismatch between the timing of expected receipts and actual cash availability forces the bank to find alternative funding sources.

35. (A) P-4, Q-2, R-1, S-3

Interest rate risks are triggered by specific financial scenarios. Gap risk is caused by assets and liabilities having different repricing dates. Basis risk occurs when interest rates change in different magnitudes for various instruments. Yield curve risk arises from non-parallel shifts in the curve. Finally, embedded option risk is triggered by customer actions, such as the premature withdrawal of term deposits.

36. (D) Model Risk

Model risk refers to the potential for financial loss due to errors in the design or implementation of mathematical models. When a massive gap exists between what a model predicts and what actually happens in the market, it indicates that the model's assumptions or data inputs are flawed. This risk is particularly high in complex financial environments where market dynamics change rapidly.

37. (D) P-3, Q-1, R-4, S-2

Banking concepts have distinct operational traits. The banking book typically attracts credit risk charges rather than market risk. The trading book requires a daily mark-to-market system to reflect current values. Off-balance sheet items consist of non-fund based credit facilities that may become fund-based later. Finally, pricing models are validated using back testing to ensure they accurately predict market behaviors.

38. (C) Personnel who are not involved in the design of the model.

To ensure the objectivity and integrity of the model validation process, it must be performed by individuals who were not part of the model's development. Independent validation helps identify hidden biases, logical errors, or unrealistic assumptions that the original designers might have overlooked. This separation of duties is a fundamental principle of effective risk management within financial institutions.

39. (B) Time Risk - Arises from the need to compensate for non-receipt of expected inflows of funds.

Time risk is correctly identified as the risk arising when anticipated cash inflows, such as loan repayments, are not received as scheduled. This creates a temporary liquidity gap. In contrast,

funding risk involves replacing net outflows from deposit withdrawals, and call risk relates to the crystallization of contingent liabilities. Reinvestment risk is an interest rate risk, not a liquidity risk.

40. (A) Mitigation policies

Transition risks under climate risk include changes resulting from new government policies aimed at reducing carbon emissions. When a bank's clients face credit downgrades because they cannot comply with these strict environmental regulations, it is a direct consequence of climate-related mitigation policies. These policies force industries to adjust their business models, often leading to increased costs and financial strain.

41. (A) Net Interest Position Risk - Bank holds more paying liabilities than earning assets and market rates adjust upwards.

Net Interest Position Risk describes the threat to earnings when interest rates move in a direction that harms the bank's specific asset-liability balance. When a bank holds more paying liabilities than earning assets, an upward adjustment in market interest rates increases the interest expense on liabilities more than the income generated from assets. This scenario leads to a reduction of the bank's total net interest income.

42. (B) Recording revenue before receipt of payment or expenses before actual cash outflow.

The accrual system of accounting recognizes economic events regardless of when cash transactions occur. Under this method, revenue is recorded when it is earned, and expenses are documented when they are incurred. This provides a more accurate picture of a bank's financial health and performance over a specific period compared to cash-based accounting, which only tracks actual money movements.

43. (D) Statement I is incorrect, but Statement II is correct.

The banking book is not subject to daily mark-to-market exercises; instead, it uses the accrual system for assets intended to be held until maturity. The trading book, however, is exposed to various risks including market, credit, and operational risks. Because trading positions are actively managed for profit, they must be

- 80.** (D) Commercial Banking - Project finance and trade finance.

Commercial banking is correctly associated with providing finance to businesses for projects and international trade. This involves managing corporate loans and credit facilities. In contrast, depository receipts belong to agency services, and fixed income trading is part of trading and sales. While factoring and leasing are commercial banking activities, project and trade finance are its most defining and common characteristics.

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53. (D) I, II, and IV

The accrual system recognizes income when earned and expenses when incurred, regardless of cash flow timing. This method is the standard for assets and liabilities in the banking book. However, it is not applied to the trading book. The trading book instead uses a mark-to-market system to account for frequent price changes, ensuring that the portfolio's value reflects current markets.

54. (C) Non-fund based exposures that become fund-based upon the occurrence of certain contingent events.

Off-balance sheet exposures are initially non-fund based, meaning they do not involve immediate cash movement. They include instruments like letters of credit and guarantees. These items convert into fund-based exposures only if a specific event occurs, such as a customer's failure to pay a third party. This contingency requires the bank to provide funds, moving the exposure onto the balance sheet.

55. (B) I, II, and III

Forex risk involves losses from exchange rate movements, and market risk covers commodity pricing, such as gold. Currency depreciation typically hurts importers by making foreign goods more expensive. However, banks are generally not permitted to take large speculative positions in commodities for hedging purposes in most regulatory environments; their commodity exposure is usually limited to specific assets like gold.

56. (A) The need to compensate for non-receipt of expected inflows of funds, such as unpaid EMIs.

Time risk is a subset of liquidity risk that focuses on the timing of cash receipts. It materializes when a bank expects funds to arrive from borrowers, such as monthly loan installments, but those payments are delayed or missed. This creates a temporary shortfall that the bank must cover using other resources to meet its own outgoing cash obligations on time.

57. (A) I, II, IV, and V

Banking business lines are categorized by their specific functions. Mergers and acquisitions fall under corporate finance, while market making belongs to trading and sales. Agency

services include escrow and custody, and asset management covers discretionary fund management. However, retail lending is part of retail banking, and project finance is typical of commercial banking, meaning the third statement is incorrect.

58. (B) They are subjected to a strict daily mark-to-market (MTM) exercise.

Assets in the banking book, such as loans and long-term deposits, are traditionally held to maturity and accounted for using the accrual system. Unlike the trading book, they are not subjected to daily mark-to-market revaluations. This accounting approach reflects the bank's intent to collect interest income over time rather than profit from short-term price volatility in the public market.

59. (A) I, II, IV, and V

Gap risk involves mismatching dates, basis risk concerns varying rate magnitudes, and yield curve risk stems from non-parallel shifts. Net interest position risk occurs when an asset-heavy bank faces falling rates. However, embedded option risk is caused by customer-led actions like prepayments, not by uncertainty in reinvestment rates. Reinvestment risk is its own distinct category of interest rate risk.

60. (C) Standard definitions strictly include strategic risk and reputation risk.

Operational risk focuses on failures of people, systems, and internal processes. While transaction and compliance risks are core components, standard regulatory definitions of operational risk, such as those under Basel frameworks, specifically exclude strategic and reputational risks. These two categories are managed independently because they involve different drivers and requires separate management approaches within the broader bank structure.

61. (B) I, II, III, and V

Credit risk involves borrower default on loans or bonds, while counterparty risk is a transient form related to trading. Country risk arises from government restrictions that prevent payment. These are all accurate descriptions of credit-related threats. However, Herstatt risk is a variant of settlement risk within counterparty risk, not

country risk, making the fourth statement in the list incorrect.

- 62.** (C) Strict adherence to accurate parameters without any simplification.

Model risk typically arises when models are compromised by incorrect assumptions, outdated data, or the mishandling of statistical outliers. Simplification of parameters is another common cause, as it may ignore vital market factors. Conversely, if a model strictly adheres to accurate and comprehensive parameters without oversimplification, it is actually less likely to suffer from model risk, as it reflects the market more precisely.

- 63.** (D) Assertion (A) is false, but Reason (R) is true. The assertion is false because banking book assets primarily attract a capital charge for credit risk, not market risk. These assets are held for long-term income and are not traded frequently. The reason provided is true, as the banking book is indeed not open to the market and its assets are normally held until maturity, explaining why credit risk is dominant.

- 64.** (D) Strategic risk

Operational risk covers losses from internal failures, fraud, and legal issues. While model risk is often included under the broader operational umbrella in some frameworks, strategic risk is distinctly excluded. Strategic risk involves the potential failure of a bank's high-level business plans and decisions. Because it deals with the institution's overall direction, it is managed as a separate risk category.

- 65.** (D) Assertion (A) is false, but Reason (R) is true. The assertion is false because model validation must be performed by independent personnel, not the original designers, to ensure an unbiased review. The reason is true because back testing is a standard and vital method for conducting this validation. Back testing compares a model's predicted values with actual observed market outcomes to determine the model's overall accuracy and reliability.

- 66.** (C) Ocean acidification and extreme weather variability.

Transition risks are the economic and regulatory shifts that occur while moving toward a low-

carbon economy. These include new mitigation policies, technological shifts, and changes in public sentiment. Ocean acidification and extreme weather variability, however, are physical manifestations of climate change. Therefore, they are categorized as physical risks rather than transition risks, representing direct environmental damage instead of economic policy adjustments.

- 67.** (A) Basis Risk

Basis risk arises when the interest rate benchmarks of assets and liabilities do not move in perfect sync. In this scenario, the bank's loan is linked to a variable repo rate, while its funding source is a fixed-rate deposit. Because these two rates are tied to different benchmarks—one floating and one fixed—the bank is exposed to fluctuations in the spread between them.

- 68.** (D) Enhancing risk-adjusted expected return.

The fundamental goal of managing any banking business line is to maximize profitability relative to the risks taken. This is known as enhancing the risk-adjusted expected return. By evaluating potential gains against the likelihood and impact of various risks, such as credit or market volatility, banks can make more informed decisions and allocate capital more efficiently for long-term stability.

- 69.** (D) The bank has experienced favorable basis shifts.

When interest rates adjust in a way that increases a bank's net interest income, it signifies that the basis has shifted in the bank's favor. This happens when the rates on earning assets increase more than the rates on paying liabilities, or decrease less. Such favorable shifts improve the bank's margins and demonstrate the potential upside of managing mismatched interest rate sensitivities.

- 70.** (C) It arises due to the crystallization of contingent liabilities when customers do not meet commitments.

Call risk is a specific liquidity risk that occurs when off-balance sheet items, like guarantees or letters of credit, are suddenly triggered. This happens when a bank's customer fails to meet their own obligations to a third party. The bank must then provide the funds immediately to

fulfill the commitment, creating a sudden and often unanticipated demand for liquidity.

71. (B) Market Liquidity Risk

Market liquidity risk refers to the inability of an institution to sell an asset quickly at its current market price due to low trading volume or market disruption. When XYZ Bank tries to sell corporate bonds but finds no buyers without significantly lowering the price, it is facing this risk. It is distinct from funding liquidity risk, which concerns meeting cash obligations.

72. (A) II, IV, I, III

The process begins when the bank issues a non-fund based commitment, like a credit line. Next, the maturity or due date for that commitment arrives. If the customer fails to meet their obligation at this point, the contingent liability is triggered. Finally, the bank must provide the actual funds to meet the obligation, thereby converting the exposure into a fund-based liability.

73. (A) Funding Risk

Funding risk is the danger that a bank will be unable to replace maturing liabilities or meet cash outflows as they occur. When institutional investors unexpectedly choose not to renew their wholesale term deposits, the bank loses a significant source of cash. This forces the institution to find alternative funding, often at a higher cost, to maintain its overall liquidity levels.

74. (B) P-2, Q-4, R-1, S-3

Banking business lines are divided into specific operational subgroups. Asset management includes non-discretionary fund management for clients. Retail brokerage involves execution and full-service trading for individuals. Agency services provide custody and settlement functions. Finally, trading and sales activities include market making, where the bank provides liquidity to the market by maintaining buy and sell prices for various financial instruments.

75. (A) Call Risk

Call risk is the type of liquidity risk that materializes when contingent liabilities are triggered. For example, if a corporate client fails to fulfill a contract backed by a bank guarantee,

the bank is “called” to pay. This event requires an immediate cash outflow that was previously non-fund based. Managing call risk involves ensuring the bank has sufficient reserves.

76. (C) P-3, Q-1, R-4, S-2

Specific risks are nested within broader banking risk categories. Fraud risk is a key element of operational risk. Herstatt risk, a type of settlement failure, falls under credit risk. Foreign currency risk is a major component of market risk due to exchange rate volatility. Lastly, call risk is a form of liquidity risk associated with the sudden triggering of contingent liabilities.

77. (B) Ignoring one or more parameters for simplification.

Model risk often stems from the deliberate simplification of complex market realities. When designers ignore certain parameters to make a model easier to use or process, they may leave out critical variables that significantly influence actual outcomes. This oversight leads to a gap between the model’s predictions and the real-world results, resulting in potential financial losses for the institution.

78. (C) P-3, Q-1, R-2, S-4

Climate risk components have distinct features. Acute physical risks include sudden disasters like floods. Chronic physical risks involve long-term changes like rising sea levels. Mitigation policies can lead to credit rating downgrades for carbon-intensive companies as they struggle with new regulations. Finally, technological advances in transition risk are characterized by the increased adoption of sustainable, non-fossil fuel energy sources.

79. (D) Physical Risks

Physical risks arise from the direct impact of environmental changes on physical assets and infrastructure. Rising sea levels and extreme weather variability are long-term or severe climate phenomena that can cause extensive property damage to manufacturing facilities. These risks directly affect the value of collateral held by banks and the operational capacity of their borrowers in the affected coastal regions.

- (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2015

7. Identify the incorrect statement regarding the range of eligible guarantors for Credit Risk Mitigation.

- (A) Sovereigns, entities like BIS and IMF, and banks with a lower risk weight than the counterparty are recognised.
 (B) Credit protection provided by a parent company can be recognised when it has a lower risk weight than the obligor.
 (C) When credit protection is provided to a securitisation exposure, eligible entities must be externally rated BBB- or better currently.
 (D) In case of securitisation transactions, Special Purpose Entities (SPEs) can be recognised as eligible guarantors.

May/June 2013

8. Which of the following statements correctly describe the framework for Domestic Systemically Important Banks (D-SIBs)?

- I The framework targets banks that are deemed "Too Big To Fail".
 II A cut-off score determines whether banks will be considered as D-SIBs.
 III Banks are plotted into different buckets based on their systemic importance scores.
 IV Higher capital requirements for D-SIBs are applied exclusively in the form of Additional Tier 2 capital.
 V Designated major banks in an economy are typically classified as D-SIBs.

- (A) I, II, III, and IV only
 (B) II, III, IV, and V only
 (C) I, III, IV, and V only
 (D) I, II, III, and V only

Oct/Nov 2022

9. Identify the incorrect statement concerning the Internal Rating Based (IRB) approach for credit risk.

- (A) For retail exposures, both Foundation and Advanced IRB approaches are prescribed.
 (B) In the Foundation IRB approach, the bank provides the inputs for Probability of Default (PD).
 (C) In the Advanced IRB approach, the bank provides inputs for Loss Given Default

(LGD) and Exposure At Default (EAD).

- (D) In the Foundation IRB approach, the supervisor provides the inputs for Loss Given Default (LGD) and Exposure At Default (EAD).

May/June 2008

10. The market risk positions subject to capital charge requirements encompass which of the following?

- I Securities included under the Held for Trading category.
 II Securities included under the Available for Sale category.
 III Open gold position limits.
 IV Open foreign exchange position limits.
 V Securities included under the Held to Maturity category.

- (A) I, III, IV, and V only
 (B) II, III, IV, and V only
 (C) I, II, III, and IV only
 (D) I, II, III, IV, and V

Oct/Nov 2025

11. Which of the following statements correctly reflects a principle of the Supervisory Review Process (SRP) under Pillar 2?

- (A) Supervisors should expect banks to operate precisely at the minimum regulatory capital ratios without excess.
 (B) Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies.
 (C) Banks are explicitly prohibited from holding capital in excess of the minimum regulatory requirements.
 (D) Supervisors should only intervene when a bank's capital falls substantially below the minimum levels.

May/June 2022

12. Which combination of statements accurately describes the Leverage Ratio under Basel III?

- I It was introduced to constrain the build-up of leverage in the banking sector.
 II It is constructed as a heavily risk-based supplementary measure.
 III It is defined as the Capital Measure divided by the Exposure Measure.
 IV Regulatory authorities may adjust the requirement for systemically important banks to manage lending activities.

CHAPTER 13

Risk Regulations in Banking Industry

Oct/Nov 2016

1. What is the most appropriate fundamental reason driving the revision of the Basel I Accord to the Basel II Accord?
(A) Limited risk-sensitivity that incentivized higher-risk asset financing under uniform capital requirements.
(B) Basel I promoted stronger risk management practices but failed to level the playing field globally.
(C) Basel I placed excessive capital charges on unrated corporate securities and neglected to measure market risk.
(D) Basel I did not provide explicit capital cushions for trading activities and commodities.

May/June 2021

2. The definition of operational risk explicitly includes legal risk but excludes strategic and reputational risk.
Reason (R): Legal risk encompasses exposures to fines, penalties, or punitive damages resulting from supervisory actions or private settlements.
(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2007

3. Which of the following is NOT a regulatory adjustment/deduction applied to regulatory capital at solo and consolidated levels?
(A) General Provisions and Loss Reserves.
(B) Goodwill and all Other Intangible Assets.
(C) Deferred Tax Assets (DTAs).
(D) Cash Flow Hedge Reserve.

May/June 2012

4. Assertion (A): Under the Internal Ratings Based (IRB) approach, the regulator strictly dictates the

uniform risk weights for all corporate exposures independently of any bank estimates.

Reason (R): Under the Standardised approach, the risk weight of a claim is largely supported by the rating assigned by an eligible external credit rating agency.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2019

5. Counterparty Credit Risk (CCR) is defined as:
(A) Risk of counterparty default before final settlement of a transaction's cash flows.
(B) Risk that an external credit rating agency assigns an inaccurate rating to a borrower.
(C) Risk of loss resulting from inadequate or failed internal processes or systems.
(D) Risk that interest rates of different assets and liabilities change in varying magnitudes.

May/June 2014

6. The following questions consist of two statements—Assertion (A) and Reason (R). Answer the questions by selecting the appropriate option:
Assertion (A): The 1988 Basel I Accord promoted financial decision-making based on regulatory constraints rather than economic opportunities.
Reason (R): Under Basel I, the capital requirement for all corporate accounts was a uniform 8% of the 100% risk weight, regardless of their actual credit rating.
(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

frequently revalued to reflect current market conditions and volatility.

44. (C) Adverse deviations in the mark-to-market value of the trading portfolio during the period of holding.

Market risk is the possibility of losses resulting from changes in market prices, such as interest rates, equity prices, or exchange rates. It specifically concerns the volatility of assets held in the trading book, which are marked-to-market. When these asset values drop below their purchase price during the holding period, the bank incurs a loss, reflecting the inherent risk.

45. (D) Statement I is incorrect, but Statement II is correct.

Reputational risk is generally categorized as an indirect risk rather than a direct component of operational risk in standard banking frameworks. Strategic risk involves a critical assessment of a bank's business direction and implementation. It focuses on the gap between intended goals and actual outcomes, ensuring that the bank's long-term objectives remain viable and that resources are used effectively.

46. (C) 90 days

Securities categorized as "Held for Trading" are intended for short-term gain through active buying and selling. Regulatory standards require these assets to be sold within a maximum of ninety days to maintain the liquidity and purpose of the trading book. This timeframe ensures that the bank does not hold onto speculative positions for too long, which would change their risk profile.

47. (D) I and II only

The trading book follows a mark-to-market system where value changes are recorded in the profit and loss account. It typically includes fixed income securities and equities held for short-term gain. However, positions in the trading book are not held until maturity; instead, they are intended for liquidation in the market to capitalize on price movements, making the third statement incorrect.

48. (D) Strategic risk and Reputation risk

While the scope of operational risk is broad, including internal failures and external events,

certain risks are traditionally excluded from its formal definition. Strategic risk, which concerns long-term business decisions, and reputation risk, which involves public perception, are managed as separate categories. This distinction helps banks apply specific management techniques and capital allocation strategies to each unique type of risk.

49. (B) I and II only

Transaction risk arises from internal failures or fraud, while compliance risk, also known as integrity risk, relates to adhering to laws and ethical standards. These are core parts of operational risk. Model risk, however, is defined by errors in mathematical predictions, not by losses from adverse public opinion. Public opinion is the domain of reputation risk, which is distinct.

50. (C) It is not open to the market and assets are normally held until maturity.

The banking book primarily contains loans, advances, and deposits that are not intended for active trading. Because these assets are typically held until they mature, they are not subject to the daily price fluctuations of the public market. Instead, they are managed through the accrual system, which focuses on interest income and credit quality rather than short-term price changes.

51. (A) I and III only

Funding risk involves the need to replace cash outflows from premature deposit closures. Call risk arises when the bank must fulfill contingent liabilities or when it misses profitable opportunities due to lack of funds. However, the statement regarding time risk is incorrect because time risk specifically relates to the non-receipt of expected inflows, such as delayed loan payments.

52. (D) Gap or Mismatch Risk

Gap or mismatch risk occurs when a bank's assets and liabilities have different maturities or repricing dates. This imbalance creates sensitivity to interest rate changes. If the bank has more assets maturing or repricing in a certain period than liabilities, it is exposed to the risk that interest rates will change, potentially reducing the net interest margin and bank profitability.

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, II, and IV only
- (D) I, III, and IV only

Oct/Nov 2009

13. Which of the following statements correctly describes the operational mechanics of the Capital Conservation Buffer (CCB)?
- (A) The CCB is designed to ensure banks build up capital buffers during stressed periods to be drawn down in normal times.
 - (B) A bank found to have allowed its CCB to fall in normal times will have its operations and lending activities immediately halted.
 - (C) The CCB requirement is comprised exclusively of Additional Tier 1 capital.
 - (D) The constraints imposed on a bank when its capital level falls within the conservation range are related to capital distributions only.

May/June 2017

14. Which combination of statements correctly reflects the rules for calculating “Gross Income” under the Basic Indicator Approach for operational risk?
- I It must exclude income from legal settlements in favour of the bank.
 - II It must exclude realised profits/losses from the sale of securities in the “held to maturity” category.
 - III It must be net of operating expenses, excluding fees paid to outsourcing service providers.
 - IV It must exclude reversals of provisions and write-offs made during the previous year.
- (A) I, III, and IV only
 - (B) II, III, and IV only
 - (C) I, II, and IV only
 - (D) I, II, and III only

Oct/Nov 2024

15. In the context of the market risk capital charge, why is a vertical disallowance of netted positions applied?
- (A) To address the risk of failure of the whole banking system due to contagion.
 - (B) Basis risk from non-identical interest rate changes for assets and liabilities across maturities.
 - (C) To offset the currency mismatch between

the collateral and the underlying exposure.

- (D) To adjust for the credit migration risk of the counterparty reflected in mark-to-market losses.

May/June 2011

16. Which combination of statements correctly describes the Internal Rating Based (IRB) approach options?
- I In the Foundation IRB Approach, the bank provides the Probability of Default (PD).
 - II In the Advanced IRB Approach, the bank provides both Loss Given Default (LGD) and Exposure At Default (EAD).
 - III In the Foundation IRB Approach, the committee/supervisor provides the LGD and EAD.
 - IV For retail exposures, banks are permitted to choose between the Foundation and Advanced IRB approaches.
- (A) II, III, and IV only
 - (B) I, III, and IV only
 - (C) I, II, and III only
 - (D) I, II, and IV only

Oct/Nov 2013

17. Which of the following best distinguishes going-concern capital from gone-concern capital from a regulatory perspective?
- (A) Capital absorbing losses without triggering bankruptcy, whereas gone-concern capital absorbs losses only in liquidation.
 - (B) Capital absorbing losses during liquidation, whereas gone-concern capital proactively prevents bankruptcy.
 - (C) Going-concern capital includes Tier 2 capital, while gone-concern capital includes Tier 1 capital.
 - (D) Going-concern capital is exclusively comprised of debt, whereas gone-concern capital is comprised of equity.

May/June 2023

18. Identify the correct combination of statements regarding On-Balance Sheet Netting:
- I For capital adequacy calculation, loans/advances are treated as collateral and deposits are treated as exposure.
 - II Haircuts will be zero except when a currency mismatch exists between the loans and the deposits.
 - III The bank must have a well-founded legal

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where such techniques are not used.

- (B) The effects of CRM can be double counted if an issue-specific rating is used that already reflects that CRM.
- (C) Principal-only ratings will not be allowed within the CRM framework.
- (D) While the use of CRM techniques reduces credit risk, it simultaneously may increase residual risks such as legal and operational risks.

May/June 2006

76. Which combination of statements correctly describes the four key principles of the Supervisory Review Process (SRP) under Pillar 2?
- I Banks should have a process for assessing their overall capital adequacy and a strategy for maintaining capital levels.
 - II Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies.
 - III Supervisors should expect banks to operate precisely at the minimum regulatory capital ratios without excess.
 - IV Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels.
- (A) I, II, and III only
 - (B) I, II, and IV only
 - (C) I, III, and IV only
 - (D) II, III, and IV only

Oct/Nov 2017

77. A bank has an original exposure of Rs. 100 lakhs and an exposure haircut (He) of 5%. If the fully adjusted collateral value (P) after accounting for maturity mismatch is Rs. 21.89 lakhs, what is the final net exposure (E*) qualifying for capital adequacy?
- (A) Rs. 78.11 lakhs
 - (B) Rs. 83.11 lakhs
 - (C) Rs. 100.00 lakhs
 - (D) Rs. 105.00 lakhs

May/June 2024

78. Which of the following instruments is NOT eligible for recognition as financial collateral in the comprehensive approach?
- (A) Cash on deposit with the bank which is incurring the counterparty exposure.
 - (B) Kisan Vikas Patra provided no lock-in

period is operational.

- (C) Gold bullion and jewellery after notionally converting to 99.99 purity.
- (D) Re-securitisations, irrespective of any credit ratings.

Oct/Nov 2012

79. Under the Basic Indicator Approach (BIA), a bank has recorded the following gross income over the previous three years: Year 1 = Rs. 400 Crores, Year 2 = Rs. -100 Crores, Year 3 = Rs. 500 Crores. What is the average gross income to be considered for calculating the operational risk capital charge?
- (A) Rs. 266.67 Crores
 - (B) Rs. 300 Crores
 - (C) Rs. 400 Crores
 - (D) Rs. 450 Crores

May/June 2016

80. A corporate borrower has a sanctioned term loan of Rs. 300 lakhs, of which Rs. 100 lakhs is disbursed. Out of the undisbursed portion, Rs. 50 lakhs is scheduled to be drawn within 1 year, and Rs. 150 lakhs is scheduled to be drawn after 1 year. What is the exposure on account of the un-availed portion of the term loan?
- (A) Rs. 40 lakhs
 - (B) Rs. 60 lakhs
 - (C) Rs. 85 lakhs
 - (D) Rs. 100 lakhs

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(D) BBB - 150%

Oct/Nov 2014

27. Based on Basel III guidelines for banks, if the Minimum Total Capital Ratio is 9% and the Capital Conservation Buffer is 2.5%, what is the required Minimum Total Capital Ratio plus the Capital Conservation Buffer (%) that the bank must maintain?
- (A) 9.0%
(B) 10.5%
(C) 11.5%
(D) 12.0%

May/June 2009

28. Which of the following statements correctly identifies a salient feature of the 1996 Amendment to Include Market Risk?
- (A) It mandated a uniform risk weight of 20% for all inter-bank exposures.
(B) It allowed banks to issue long-term subordinated debt subject to a lock-in clause as Tier 1 capital.
(C) Allowing proprietary VAR models with a 99th percentile confidence level and a 10-day horizon.
(D) It eliminated the requirement to segregate the trading book from the banking book.

Oct/Nov 2021

29. Which combination of statements correctly identifies eligible financial collateral under the comprehensive approach?
- I Gold bullion and jewellery, converted notionally to 99.99 purity.
II Kisan Vikas Patra provided they can be encashed within the holding period.
III Debt securities issued by banks, listed on a recognised exchange, and classified as senior debt.
IV Re-securitisations, provided they possess a AAA external credit rating.
- (A) I, II, and IV only
(B) I, III, and IV only
(C) II, III, and IV only
(D) I, II, and III only

May/June 2018

30. How does the capital conservation buffer (CCB) framework aim to reduce pro-cyclicality?
- (A) By imposing strict limits on the origination of new loans during economic booms.

- (B) By requiring banks to liquidate assets during early stages of economic recovery.
(C) By transferring systemic risks to unregulated and unmonitored shadow entities.
(D) Retaining earnings during downturns to ensure capital supports ongoing business.

Oct/Nov 2010

31. Consider the following statements regarding Risk Based Supervision (RBS):
- I RBS recommendations moved away from transaction-centric CAMELS and CALCS approaches.
II Stress testing is an integral part of the supervisory process under RBS.
III The supervisory rating derived under RBS is published periodically to enhance market discipline.
- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

May/June 2015

32. What is the primary effect of economic deregulation that necessitated risk-based regulation in a changed world environment?
- (A) It strictly limited the scope of operations of credit institutions.
(B) It eliminated cross-border transactions and global competition.
(C) Competition among inexperienced players heightening overall systemic risks.
(D) It created an environment where monetary management priorities were entirely abandoned.

Oct/Nov 2008

33. Identify the correct combination of statements concerning the Capital Conservation Buffer (CCB):
- I The CCB is comprised entirely of Tier 2 capital.
II Capital distribution constraints will be imposed on a bank when its capital level falls within the conservation range.
III The constraints imposed on banks falling into the conservation range relate to distributions only and are not related to the operations of banks.
- (A) I and II only
(B) II and III only

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Oct/Nov 2023

63. What is the most appropriate rationale for subjecting Domestic Systemically Important Banks (D-SIBs) to higher capital requirements?
- (A) To offset the higher profitability margins they enjoy compared to smaller domestic banks.
- (B) To ensure they meet the Liquidity Coverage Ratio (LCR) strictly before the transition period ends.
- (C) Reducing failure probability of institutions whose collapse would severely damage the real economy.
- (D) To standardise their internal risk models exclusively using the Basic Indicator Approach.

May/June 2025

64. A bank has an exposure of Rs. 100 lakhs. This exposure is backed by a financial collateral of Rs. 40 lakhs in the form of a corporate bond. The tenor of the exposure is 3 years, while the residual maturity of the collateral is 2 years. The haircut applicable to the exposure (H_e) is 5%, and the haircut for the collateral (H_c) is 6%. Assuming a currency mismatch exists and attracts a haircut (H_{fx}) of 8%, what is the value of the haircut-adjusted collateral (C^*) before adjusting for maturity mismatch?
- (A) Rs. 34.40 lakhs
- (B) Rs. 35.20 lakhs
- (C) Rs. 36.80 lakhs
- (D) Rs. 37.60 lakhs

Oct/Nov 2020

65. Which of the following is NOT one of the five groups of the Basel Committee?
- (A) Policy Development Group
- (B) Accounting Experts Group
- (C) Financial Stability Enforcement Group
- (D) Supervision and Implementation Group

May/June 2010

66. Assertion (A): Under Basel III, the portion of minority interest which supports risks in a subsidiary that is a bank is included in the group's Common Equity Tier 1 capital.
- Reason (R): Minority interest in subsidiaries which are non-financial or non-bank entities is also fully included in the regulatory capital of the consolidated group without exclusions.
- (A) Both Assertion (A) and Reason (R) are true,

and Reason (R) is the correct explanation of Assertion (A).

- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

67. Under the Comprehensive Approach for collateralised transactions, what is the most appropriate purpose of applying "haircuts"?
- (A) To double count the effects of Credit Risk Mitigation across the trading and banking books.
- (B) To determine the qualitative eligibility of the credit rating agencies assigning the collateral values.
- (C) To automatically cancel the underlying exposure if the counterparty's creditworthiness deteriorates.
- (D) To account for possible future fluctuations in the value of the exposure and the collateral occasioned by market movements.

May/June 2005

68. The following questions consist of two statements—Assertion (A) and Reason (R). Answer the questions by selecting the appropriate option:
- Assertion (A): Systemic risk arises largely from the interconnectedness and interdependence of various players in the financial market.
- Reason (R): The failure of a single bank generates a risk of failure for all other banks that have ongoing commitments and receivables with the defaulting bank.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2014

69. Which of the following is NOT one of the primary goals of regulatory authorities in regulating the banking industry?
- (A) Controlling and monitoring Systemic Risk.
- (B) Protecting the interest of depositors.

May/June 2007

42. A bank has Total Risk Weighted Assets (RWAs) of Rs. 100,000 Crores. If the Minimum Total Capital Ratio (MTC) is 9%, what is the absolute minimum Total Capital amount required to meet this ratio, excluding the Capital Conservation Buffer?
- (A) Rs. 7,000 Crores
(B) Rs. 8,000 Crores
(C) Rs. 9,000 Crores
(D) Rs. 11,500 Crores

Oct/Nov 2016

43. Which of the following is correctly paired regarding the Internal Rating Based (IRB) approach parameters?
- (A) Probability of Default (PD) - Estimates the specific likelihood that a borrower defaults within a given financial year.
(B) Exposure At Default (EAD) - Estimated amount of a facility likely to be drawn down in the event of default.
(C) Loss Given Default (LGD) - Estimates the percentage of total exposure lost following an actual default event.
(D) Maturity (M) - Measures the qualitative risk grade assigned by an external rating agency.

May/June 2021

44. A borrower has an outstanding fund-based balance of Rs. 100 lakhs. The credit equivalent amounts of un-availed term loans and non-fund based facilities are Rs. 85 lakhs and Rs. 65 lakhs respectively. What is the total credit equivalent exposure on the borrower?
- (A) Rs. 165 lakhs
(B) Rs. 185 lakhs
(C) Rs. 250 lakhs
(D) Rs. 300 lakhs

Oct/Nov 2007

45. Match the Basel Framework elements in List-I with their corresponding features in List-II.
- List I: (Basel Framework Elements)
P. Pillar 1
Q. Pillar 2
R. Pillar 3
S. Basel III enhancement
- List II: (Feature)
1. Supervisory Review Process
2. Capital Conservation Buffer
3. Market Discipline

4. Minimum Capital Requirement

- (A) P-4, Q-1, R-3, S-2
(B) P-1, Q-4, R-2, S-3
(C) P-4, Q-3, R-1, S-2
(D) P-3, Q-1, R-4, S-2

May/June 2012

46. A corporate borrower has outstanding Non-Fund Based (NFB) facilities comprising a Performance Guarantee of Rs. 50 lakhs (CCF = 50%) and a Financial Guarantee of Rs. 40 lakhs (CCF = 100%). What is the total credit equivalent amount for these non-fund based exposures?
- (A) Rs. 45 lakhs
(B) Rs. 65 lakhs
(C) Rs. 90 lakhs
(D) Rs. 130 lakhs

Oct/Nov 2019

47. Match the type of non-fund-based exposure in List-I with its applicable Credit Conversion Factor (%) in List-II.

List I: (Type of Non-fund-based Exposure)

- P. Unconditional take-out finance
Q. Performance bonds
R. Documentary credit collateralized by underlying shipment
S. Commitments unconditionally cancellable at any time

List II: (Credit Conversion Factor %)

1. 0%
2. 20%
3. 50%
4. 100%
- (A) P-4, Q-3, R-2, S-1
(B) P-3, Q-4, R-1, S-2
(C) P-4, Q-2, R-3, S-1
(D) P-2, Q-3, R-4, S-1

May/June 2014

48. Based on an average gross income of Rs. 450 Crores calculated under the Basic Indicator Approach ($\alpha = 15\%$), what is the requisite capital charge for operational risk?
- (A) Rs. 54.0 Crores
(B) Rs. 67.5 Crores
(C) Rs. 81.0 Crores
(D) Rs. 90.0 Crores

Oct/Nov 2015

49. Arrange the following stages of determining Risk Weighted Assets (RWAs) for Credit Risk

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basis concluding that the netting agreement is enforceable regardless of insolvency.

- (A) I, II and III only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2018

19. What is the standard supervisory haircut prescribed for currency risk where exposure and collateral are denominated in different currencies?

- (A) 0 per cent
- (B) 6 per cent
- (C) 8 per cent
- (D) 25 per cent

May/June 2019

20. Identify the correct combination of statements regarding Counterparty Credit Risk (CCR):

- I CCR creates a bilateral risk of loss where the market value of the transaction can be positive or negative to either counterparty.
- II Current Exposure is also referred to as Replacement Cost.
- III Credit Valuation Adjustment only reflects the market value of the credit risk of the counterparty, excluding the bank's own credit risk.

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2023

21. Under the Basic Indicator Approach for operational risk, what is the fixed percentage (alpha) of positive annual gross income set by the BCBS?

- (A) 8 per cent
- (B) 9 per cent
- (C) 12 per cent
- (D) 15 per cent

May/June 2025

22. Evaluate the following statements regarding disclosures under Pillar 3:

- I Under Pillar 3, disclosures related to individual banks within groups would not generally be required to be made by the parent bank.
- II Pillar 3 disclosures should be made

concurrently with the publication of financial results/statements.

- (A) Both Statement I and Statement II are true.
- (B) Both Statement I and Statement II are false.
- (C) Statement I is true but Statement II is false.
- (D) Statement I is false but Statement II is true.

Oct/Nov 2020

23. Variation margin is defined as:

- (A) Funded collateral posted to mitigate potential future exposure from possible value changes.
- (B) An adjustment to the mid-market valuation of a portfolio of trades with a counterparty.
- (C) The specific margin maintained to mutualise losses among all active clearing members.
- (D) Collateral posted daily to a CCP based upon price movements of transactions.

May/June 2010

24. Evaluate the following statements regarding liquidity risk metrics:

- I The Liquidity Coverage Ratio (LCR) is intended to address maturity mismatches over the entire balance sheet.
- II The Net Stable Funding Ratio (NSFR) is intended to provide enough cash to cover funding needs over an acute 30-day period of stress.

- (A) Both Statement I and Statement II are true.
- (B) Both Statement I and Statement II are false.
- (C) Statement I is true but Statement II is false.
- (D) Statement I is false but Statement II is true.

Oct/Nov 2005

25. Counterparty Credit Risk (CCR) is defined as:

- (A) Risk of counterparty default before final settlement of a transaction's cash flows.
- (B) Risk that an external credit rating agency assigns an inaccurate rating to a borrower.
- (C) Risk of loss resulting from inadequate or failed internal processes or systems.
- (D) Risk that interest rates of different assets and liabilities change in varying magnitudes.

May/June 2005

26. Which of the following pairs of Credit Rating and its corresponding Standardised Approach Risk Weight is incorrectly matched?

- (A) AAA - 20%
- (B) AA - 30%
- (C) A - 50%

- (C) Rs. 7,000 Crores
(D) Rs. 8,000 Crores

Oct/Nov 2024

57. Match the D-SIB Buckets in List-I with the corresponding Additional CET1 Capital Charge in List-II.

List I: (D-SIB Bucket)

- P. Bucket 4
Q. Bucket 3
R. Bucket 2
S. Bucket 1

List II: (Additional CET1 Capital Charge)

1. 0.20%
2. 0.40%
3. 0.60%
4. 0.80%
(A) P-4, Q-3, R-2, S-1
(B) P-1, Q-2, R-3, S-4
(C) P-3, Q-4, R-1, S-2
(D) P-4, Q-2, R-3, S-1

May/June 2011

58. Match the time bands in List-I with their Assumed Change in Yield under the Standardized Duration method in List-II.

List I: (Time Bands)

- P. 1 month or less
Q. 1.9 to 2.8 years
R. 4.3 to 5.7 years
S. 12 to 20 years

List II: (Assumed Change in Yield)

1. 0.80
2. 1.00
3. 0.60
4. 0.70
(A) P-2, Q-1, R-4, S-3
(B) P-1, Q-2, R-3, S-4
(C) P-2, Q-4, R-1, S-3
(D) P-3, Q-1, R-4, S-2

Oct/Nov 2013

59. Match the specific risk or process in List-I with its corresponding measurement approach or component in List-II.

List I: (Risk or Process)

- P. Credit Risk
Q. Market Risk
R. Operational Risk
S. Pillar 2

List II: (Measurement Approach or Component)

1. Standardised Duration Method

2. Advanced Measurement Approach
3. Internal Capital Adequacy Assessment Process
4. Internal Ratings Based (IRB) Foundation Approach
(A) P-1, Q-2, R-3, S-4
(B) P-4, Q-1, R-2, S-3
(C) P-4, Q-2, R-1, S-3
(D) P-2, Q-1, R-4, S-3

May/June 2023

60. If the operational risk capital charge for a bank is Rs. 67.5 Crores, and the minimum capital requirement is 8%, what is the equivalent Risk Weighted Assets (RWA) value for operational risk?

- (A) Rs. 540.00 Crores
(B) Rs. 675.50 Crores
(C) Rs. 843.75 Crores
(D) Rs. 925.25 Crores

Oct/Nov 2018

61. Arrange the following historical developments in banking regulation in the correct chronological order:

- I. Publication of the Minimum standards for the supervision of international banking groups and their cross-border establishments.
II. Release of the original "Concordat" paper.
III. Establishment of the Basel Committee on Banking Supervision (BCBS) following the Herstatt incident.
IV. The Market Risk Amendment to the Basel I Accord.

- (A) III, II, I, IV
(B) II, III, IV, I
(C) III, I, II, IV
(D) II, I, III, IV

May/June 2019

62. A bank holds a long position generating a market risk charge of Rs. 200 Crores and a short position generating a charge of Rs. 100 Crores within the same maturity band in Zone 2. What is the vertical disallowance calculated for the matched position within this specific maturity band?

- (A) Rs. 2.5 Crores
(B) Rs. 5.0 Crores
(C) Rs. 10.0 Crores
(D) Rs. 15.0 Crores

- (C) I and III only
(D) I, II, and III

May/June 2006

34. According to the regulatory capital requirements for Indian Banks under full implementation of Basel III, what is the Minimum Common Equity Tier 1 Ratio plus Capital Conservation Buffer?
- (A) 5.5%
(B) 7.0%
(C) 8.0%
(D) 11.5%

Oct/Nov 2017

35. Identify the correct combination of statements regarding the 1996 Amendment to the Basel I Accord:
- I It allowed banks to use proprietary in-house models for measuring market risks.
II It applied exclusively to the banking book exposures of commercial banks.
III It mandated the use of 'back-testing' to arrive at a 'plus factor' for capital charge multiplication.
- (A) I and II only
(B) II and III only
(C) I, II, and III
(D) I and III only

May/June 2024

36. The Basel Committee on Banking Supervision (BCBS) was established by the Central Bank Governors of the Group of Ten countries at the end of which year?
- (A) 1930
(B) 1974
(C) 1988
(D) 1996

Oct/Nov 2012

37. Evaluate the following statements regarding the Comprehensive Approach for Credit Risk Mitigation:
- I The volatility adjusted amount for the exposure will be lower than the original exposure amount.
II The volatility adjusted amount for the collateral will be higher than the original collateral amount.
- (A) Both Statement I and Statement II are true.
(B) Both Statement I and Statement II are false.
(C) Statement I is true but Statement II is false.

- (D) Statement I is false but Statement II is true.

May/June 2016

38. Modified Duration is defined as:
- (A) The weighted average of the present value of all cash flows associated with a fixed income security.
(B) The rate of change in the value of an option with respect to volatility.
(C) The percentage change in a securities' price for a 100 basis points change in yield.
(D) The minimum holding period assigned to repo-style transactions.

Oct/Nov 2006

39. Evaluate the following statements regarding the Domestic Systemically Important Banks (D-SIB) framework:
- I The D-SIB framework uses indicators such as size, interconnectedness, substitutability, and complexity to assess a bank's systemic importance.
II Domestic Systemically Important Financial Institutions (D-SIFIs) are subjected to differentiated supervisory requirements and higher intensity of supervision.
- (A) Both Statement I and Statement II are true.
(B) Both Statement I and Statement II are false.
(C) Statement I is true but Statement II is false.
(D) Statement I is false but Statement II is true.

May/June 2020

40. Systemic risk is best defined as:
- (A) The risk of failure of a bank due to internal operational fraud.
(B) The risk of systemic collapse arising from inter-institutional dependencies.
(C) The risk of a settlement failure where a counterparty fails to deliver securities.
(D) The risk of loss arising from movements in market prices relative to expected rates.

Oct/Nov 2011

41. Which of the following pairs of Market Risk Zones and Horizontal Disallowances is incorrectly matched?
- (A) Within Zone 1 - 40%
(B) Within Zone 2 - 30%
(C) Between adjacent zones - 50%
(D) Between Zone 1 and 3 - 100%

- (C) Imposing capital requirements to maximise the dividend payouts for shareholders.
- (D) Levelling the competitive playing field of banks through common benchmarks.

May/June 2009

70. Which of the following statements accurately govern haircuts under Credit Risk Mitigation (CRM)?

- I Banks may be permitted to use own-estimate haircuts based on internal volatility models in certain jurisdictions.
 - II The standard supervisory haircut for currency risk is 8 per cent.
 - III The haircut applied to unrated non-eligible instruments (like non-investment grade corporate securities) is 25 per cent.
 - IV A zero haircut may be applied for specific government-backed savings instruments.
 - V The minimum holding period assumed for a repo-style transaction is five business days.
- (A) I, II, III, and IV only
 - (B) II, III, IV, and V only
 - (C) I, III, IV, and V only
 - (D) I, II, IV, and V only

Oct/Nov 2021

71. Which of the following items is NOT excluded from the definition of "Gross income" for computing the Basic Indicator Approach capital charge?

- (A) Reversal during the year in respect of provisions and write-offs made during the previous year.
- (B) Fees paid to outsourcing service providers.
- (C) Realised profits/losses from the sale of securities in the "held to maturity" category.
- (D) Income derived by writing insurance policies and insurance claims in favour of the bank.

May/June 2018

72. Which of the following statements correctly describe the Countercyclical Capital Buffer (CCCB) framework?

- I The credit-to-GDP gap is the main indicator for CCCB activation.
- II The lower threshold of the credit-to-GDP gap for CCCB activation is set at 3 percentage points.
- III The upper threshold is kept at 15 percentage points of the credit-to-GDP gap.

- IV The maximum value of CCCB is capped at 2.5 per cent of RWA.
- V Between 3 and 15 percentage points, the CCCB requirement is maintained at a fixed 1 per cent.

- (A) I, II, III, and IV only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2010

73. Identify the incorrect statement regarding the scope and frequency of disclosures under Pillar 3.

- (A) Pillar 3 applies at the top consolidated level of the banking group to which the Capital Adequacy Framework applies.
- (B) Banks are required to make Pillar 3 disclosures at least on a half yearly basis, irrespective of whether financial statements are audited.
- (C) Disclosures related to individual banks within groups would generally be required to be made by the parent bank.
- (D) Disclosures of Capital Adequacy must be made at least on a quarterly basis.

May/June 2015

74. Which of the following elements are included in Common Equity Tier 1 (CET1) capital for banks?

- I Common shares issued by the bank that meet regulatory criteria.
 - II Stock surplus resulting from the issue of common shares.
 - III Statutory reserves.
 - IV General provisions and loss reserves held against future, unidentified losses.
 - V Capital reserves representing surplus arising out of sale proceeds of assets.
- (A) I, II, III, and V only
 - (B) I, II, III, and IV only
 - (C) II, III, IV, and V only
 - (D) I, III, IV, and V only

Oct/Nov 2008

75. Identify the incorrect statement regarding the general principles of Credit Risk Mitigation (CRM).

- (A) No transaction in which CRM techniques are used should receive a higher capital requirement than an identical transaction

under the Standardised Approach in the correct chronological order:

- I. Determining Allowable Reduction
 - II. Determining Adjusted Exposure
 - III. Consolidation of RWAs of all Exposures
 - IV. Determining Applicable Risk Weight
 - V. Determining RWA for the Exposure
- (A) II, I, IV, V, III
(B) I, II, V, IV, III
(C) II, IV, I, V, III
(D) IV, II, I, V, III

May/June 2013

50. A bank portfolio consists of a long position (Rs. 200 Crores charge) and a short position (Rs. 100 Crores charge) in the same Zone. If these are the only positions and the vertical disallowance is Rs. 5.0 Crores, what is the total general market risk capital charge for the portfolio (ignoring horizontal disallowance)?
- (A) Rs. 95 Crores
(B) Rs. 100 Crores
(C) Rs. 105 Crores
(D) Rs. 110 Crores

Oct/Nov 2022

51. Which of the following most appropriately characterizes the objective of Stress Testing within the Supervisory Review Process (SRP)?
- (A) To calculate the exact percentage of vertical disallowance required for market risk netting.
(B) To replace the external credit ratings provided by eligible credit rating agencies.
(C) To ensure that banks maintain absolute uniformity in their Board-approved policies.
(D) Assessing bank soundness and capital adequacy against potential impacts of economic downturns.

May/June 2008

52. A bank's trading book contains a long position in securities with a remaining maturity of 2.5 years (Zone 2) generating a general market risk capital charge of Rs. 200 Crores, and a short position in derivatives with a remaining maturity of 2.0 years (also Zone 2) generating a general market risk capital charge of Rs. 100 Crores. What is the net open position in Zone 2?
- (A) Rs. 50 Crores
(B) Rs. 100 Crores
(C) Rs. 150 Crores

(D) Rs. 300 Crores

Oct/Nov 2025

53. Which of the following best describes the Internal Capital Adequacy Assessment Process (ICAAP)?
- (A) It is a tool used by supervisors to set the uniform interest rates for all commercial banks.
(B) Internal procedure ensuring risk identification and capital maintenance relative to a bank's risk profile.
(C) It is a backward-looking process ensuring banks have met the absolute minimum capital requirements over the past financial year.
(D) It is a disclosure framework intended to provide market participants with data on the bank's non-performing assets.

May/June 2022

54. A bank has an exposure of Rs. 100 lakhs. The haircut-adjusted collateral (C*) is Rs. 34.40 lakhs. The tenor of the exposure is 3 years, and the residual maturity of the collateral is 2 years. What is the value of the credit risk mitigant adjusted for the maturity mismatch (P)?
- (A) Rs. 18.52 lakhs
(B) Rs. 21.89 lakhs
(C) Rs. 25.10 lakhs
(D) Rs. 28.45 lakhs

Oct/Nov 2009

55. Which of the following correctly paired regarding minimum holding periods for collateral haircuts?
- (A) Repo-style transaction - 10 business days.
(B) Other capital market transactions - 5 business days.
(C) Repo-style transaction - 20 business days.
(D) Secured lending - 20 business days.

May/June 2017

56. A bank calculates its Total Risk Weighted Assets (RWAs) as Rs. 100,000 Crores. Under Basel III norms, if the regulatory minimum CET1 ratio is 5.5%, what is the absolute minimum Common Equity Tier 1 (CET1) capital amount the bank must hold (excluding the Capital Conservation Buffer)?
- (A) Rs. 4,500 Crores
(B) Rs. 5,500 Crores

ANSWERS

1. (A) Limited risk-sensitivity that incentivized higher-risk asset financing under uniform capital requirements.
Basel I used broad risk categories that lacked granularity, often treating different credit qualities the same. This encouraged regulatory arbitrage where banks favored higher-risk assets within the same weight category. Basel II introduced more risk-sensitive measures to align capital requirements more closely with the actual credit, market, and operational risks inherent in the bank's specific portfolio.
2. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
Operational risk includes legal risk but excludes strategic and reputational risks as per international standards. While legal risk involves potential losses from fines and settlements, this specific definition does not fundamentally explain why strategic or reputational risks are excluded. These categories are handled separately because they relate to broader business decisions and public perception rather than process failures.
3. (A) General Provisions and Loss Reserves.
Regulatory capital adjustments typically involve deducting items that lack real loss-absorbing capacity or are difficult to value, such as goodwill, intangible assets, and deferred tax assets. General provisions and loss reserves are generally considered part of Tier 2 capital rather than being deducted from common equity, as they act as a buffer against future, unidentified losses during banking operations.
4. (D) Assertion (A) is false, but Reason (R) is true.
Under the Internal Ratings Based approach, banks use their internal models to estimate risk parameters like probability of default, rather than having regulators dictate uniform weights. Conversely, the Standardised approach relies on risk weights derived from external credit ratings assigned by recognised agencies. Thus, the claim regarding regulatory dictation in the first statement is incorrect regarding the internal ratings methodology.
5. (A) Risk of counterparty default before final settlement of a transaction's cash flows.
Counterparty Credit Risk refers specifically to the potential that a counterparty defaults prior to the final settlement of a transaction. This creates a bilateral risk because the contract's market value can fluctuate, making it an asset for one party or a liability for the other. It is distinct from standard credit risk on traditional loans or fixed-income securities.
6. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Basel I enforced a flat capital charge of eight percent for all corporate exposures, regardless of their actual credit quality. This lack of risk sensitivity meant that banks often prioritized higher-yielding, riskier loans over safer ones because the regulatory capital requirement was identical. Consequently, financial decisions were driven more by these regulatory constraints than by underlying economics of risk.
7. (D) In case of securitisation transactions, Special Purpose Entities (SPEs) can be recognised as eligible guarantors.
For credit risk mitigation, recognized guarantors typically include sovereign entities, central banks, and commercial banks with lower risk weights than the original counterparty. However, Special Purpose Entities are generally not recognized as eligible guarantors in securitization transactions. This restriction ensures that the credit protection provided is robust and comes from entities with established creditworthiness and transparent financial oversight.
8. (D) I, II, III, and V only
Domestic Systemically Important Banks are institutions whose failure would cause significant disruption to the local economy. Identification involves calculating systemic importance scores based on size, interconnectedness, and

ratings. While AAA and AA rated corporate exposures attract risk weights of 20% and 30% respectively, and A rated exposures attract 50%, the BBB rating category typically corresponds to a 100% risk weight. A 150% risk weight is usually reserved for much lower-rated exposures.

27. (C) 11.5%

In the Basel III framework, banks must maintain a minimum total capital ratio alongside a capital conservation buffer. If the regulatory minimum total capital requirement is set at nine percent and the capital conservation buffer is two and a half percent, the total requirement equals eleven and a half percent. Banks falling below this combined threshold face restrictions on their earnings distributions.

28. (C) Allowing proprietary VAR models with a 99th percentile confidence level and a 10-day horizon. The 1996 Amendment to the Basel I Accord introduced capital requirements for market risk. A significant feature was allowing banks to use their own proprietary Value-at-Risk models to calculate capital charges, provided they met strict criteria. These models required a 99th percentile confidence level and a ten-day holding period to ensure they adequately captured potential market losses under stress.

29. (D) I, II, and III only

Under the comprehensive approach for credit risk mitigation, eligible financial collateral includes cash, gold bullion, and certain high-quality debt securities issued by sovereigns or banks. Specific savings instruments like Kisan Vikas Patra are also recognized. However, re-securitisations are explicitly excluded from being eligible collateral, regardless of their credit rating, due to their inherent complexity and potential for high volatility.

30. (D) Retaining earnings during downturns to ensure capital supports ongoing business. The Capital Conservation Buffer addresses procyclicality by requiring banks to build up a capital cushion during periods of economic growth. When the economy enters a downturn and capital levels fall into the buffer zone, banks are forced to retain a higher percentage of their earnings. This ensures that capital remains within the banking system to support lending and losses.

31. (A) I and II only

Risk Based Supervision shifts the focus from simple transaction testing to a broader assessment of a bank's risk profile and management systems. It incorporates stress testing as a vital tool for evaluating resilience against economic shocks. While supervisors use these ratings to direct their resources, the specific ratings are generally not published to the public to avoid instability.

32. (C) Competition among inexperienced players heightening overall systemic risks.

Economic deregulation opened markets to new participants and increased global competition. This environment often led to aggressive risk-taking by inexperienced players, which heightened systemic risks. As traditional boundaries between financial services blurred, the potential for contagion grew, necessitating the development of risk-based regulations to ensure that capital requirements were sufficient to cover the increasingly complex risks in the system.

33. (B) II and III only

The Capital Conservation Buffer must be met entirely with Common Equity Tier 1 capital, not Tier 2 capital. Its primary mechanism is the imposition of distribution constraints, such as limits on dividends, when a bank's capital falls within the buffer range. These restrictions are specifically designed to preserve capital without interfering with the bank's normal business operations or lending.

34. (C) 8.0%

Under the Basel III implementation in India, the minimum Common Equity Tier 1 ratio is established at five and a half percent. When the capital conservation buffer of two and a half percent is added, the total requirement for banks is eight percent. Maintaining this combined ratio is essential for banks to avoid regulatory restrictions on the distribution of their profits.

35. (D) I and III only

The 1996 Amendment introduced capital charges for market risk in the trading book, allowing banks to use internal models for the first time. It also established 'back-testing' requirements, where model performance is compared against actual outcomes. If a model fails back-testing too

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- 17.** (A) Capital absorbing losses without triggering bankruptcy, whereas gone-concern capital absorbs losses only in liquidation.
Going-concern capital, represented by Tier 1, is designed to absorb losses while the bank continues its daily operations. This prevents insolvency and protects depositors. In contrast, gone-concern capital, such as Tier 2, is intended to absorb losses during a liquidation or winding-up process. It provides a layer of protection to depositors only after the bank has effectively failed.
- 18.** (B) II and III only
On-balance sheet netting allows banks to calculate capital based on the net exposure between loans and deposits with the same counterparty. For this to apply, the bank must have a legally enforceable netting agreement. While haircuts for currency mismatches apply, the standard treatment considers the loan as the exposure and the deposit as collateral, contrary to the first statement.
- 19.** (C) 8 per cent
When the currency of an exposure differs from the currency of the collateral, banks must account for potential exchange rate volatility. The standard supervisory haircut prescribed by the Basel framework for this currency risk is set at eight percent. This adjustment reduces the recognized value of the collateral to ensure that sufficient capital is maintained even if exchange rates fluctuate.
- 20.** (A) I and II only
Counterparty Credit Risk is bilateral, meaning either party can face a loss depending on the market value of the contract. Current exposure is synonymous with replacement cost, representing the cost of replacing the contract at market prices. However, Credit Valuation Adjustment is a pricing adjustment that reflects the market value of the counterparty's credit risk specifically, not the bank's.
- 21.** (D) 15 per cent
The Basic Indicator Approach for operational risk uses a simple calculation based on a bank's average annual gross income. The Basel Committee has set a fixed percentage, known as alpha, at fifteen percent. This factor is applied to the positive gross income over the previous three years to determine the required capital charge for absorbing potential operational risk losses.
- 22.** (A) Both Statement I and Statement II are true.
Pillar 3 focuses on market discipline through transparency. Regulations specify that disclosures should generally be made at the consolidated group level, meaning individual bank disclosures within a group are typically handled by the parent entity. Furthermore, these disclosures must be published alongside financial statements to ensure that market participants have timely access to the bank's risk and capital information.
- 23.** (D) Collateral posted daily to a CCP based upon price movements of transactions.
Variation margin refers to the collateral exchanged daily between counterparties to account for changes in the market value of their transactions. In the context of central clearing, it is paid to or received from the Central Counterparty based on daily price movements. This process ensures that potential losses are covered continuously, preventing the accumulation of large uncollateralized exposures.
- 24.** (B) Both Statement I and Statement II are false.
The Liquidity Coverage Ratio is designed to ensure banks have enough high-quality liquid assets to survive an acute stress scenario lasting thirty days. Meanwhile, the Net Stable Funding Ratio focuses on the long-term structural stability of the balance sheet over a one-year horizon. The descriptions provided in the statements incorrectly swap the primary objectives of these two regulatory metrics.
- 25.** (A) Risk of counterparty default before final settlement of a transaction's cash flows.
Counterparty Credit Risk is the specific risk that a counterparty in a transaction defaults before the final settlement of the cash flows. Unlike standard lending risk, this risk is bilateral and depends on the market value of the contract. If the contract has a positive value to the bank, the default of the counterparty results in a financial loss.
- 26.** (D) BBB - 150%
Under the Standardised Approach for credit risk, risk weights are assigned based on external credit

complexity. While these banks must hold additional capital, this requirement is satisfied through Common Equity Tier 1 capital rather than being restricted to Additional Tier 2 capital instruments as previously suggested.

9. (A) For retail exposures, both Foundation and Advanced IRB approaches are prescribed. The Internal Ratings Based framework offers different levels of complexity for assessing credit risk. While corporate, sovereign, and bank exposures distinguish between Foundation and Advanced approaches, retail exposures do not have a Foundation option. For retail portfolios, banks must provide all their own estimates, including probability of default, loss given default, and exposure at default levels for capital calculations.
10. (C) I, II, III, and IV only
Market risk capital requirements apply to instruments in the trading book, including those categorized as Held for Trading or Available for Sale. They also cover foreign exchange and gold positions across the entire bank. Securities held in the Held to Maturity category are generally excluded because they are meant to be held until they expire rather than actively traded.
11. (B) Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies.
Pillar 2 emphasizes the Supervisory Review Process, requiring regulators to evaluate how banks assess their own capital needs. This goes beyond minimum regulatory ratios to ensure that institutional strategies match their specific risk profiles. Supervisors expect banks to hold capital above the regulatory minimums to account for risks not fully captured in the Pillar 1 calculation and risk assessment.
12. (D) I, III, and IV only
The leverage ratio is a non-risk-based measure introduced to limit the excessive build-up of leverage within the banking system. It is calculated by dividing Tier 1 capital by the total exposure measure, which includes both on and off-balance sheet items. This supplementary tool ensures a minimum level of capital is maintained regardless of risk weights assigned to specific assets.

13. (D) The constraints imposed on a bank when its capital level falls within the conservation range are related to capital distributions only.

The Capital Conservation Buffer ensures that banks build up capital during profitable periods to absorb losses during stress. If a bank's capital falls into this buffer range, it faces restrictions on discretionary distributions, such as dividends and bonuses. Importantly, these constraints do not halt the bank's day-to-day operations or lending activities, allowing for continued market functioning and liquidity.

14. (C) I, II, and IV only

In the Basic Indicator Approach for operational risk, gross income serves as a proxy for risk exposure. The calculation excludes insurance income, realized gains or losses from held-to-maturity securities, and reversals of previous provisions. However, it is calculated before deducting operating expenses, though it does specifically exclude certain non-standard items to maintain a consistent measurement of core income.

15. (B) Basis risk from non-identical interest rate changes for assets and liabilities across maturities. Vertical disallowance is applied within the market risk framework to account for basis risk. This risk arises because interest rates for different instruments within the same maturity band may not move perfectly in sync. Even if positions are netted, these slight differences in yield movements can create losses. The disallowance ensures that some capital is held against this residual risk.

16. (C) I, II, and III only

Under the Foundation IRB approach, banks estimate the probability of default while supervisors provide other parameters like loss given default. In the Advanced approach, banks provide all their own estimates. For retail exposures, however, there is no distinction between Foundation and Advanced; banks must provide all parameters themselves. Thus, the fourth statement regarding retail choice is entirely incorrect.

often, a plus factor is added to the capital charge. It did not apply to banking book exposures.

36. (B) 1974

The Basel Committee on Banking Supervision was founded at the end of 1974. It was created by the central bank governors of the G10 countries in response to significant disruptions in the international financial markets, notably the failure of Bankhaus Herstatt in West Germany. The committee provides a forum for regular cooperation on banking supervisory matters to enhance global financial stability.

37. (B) Both Statement I and Statement II are false.

In the Comprehensive Approach for credit risk mitigation, volatility adjustments are applied to both the exposure and the collateral. The adjusted exposure amount is increased to account for potential price rises, while the adjusted collateral value is decreased to account for potential price falls. This conservative approach ensures that the net exposure is not underestimated during periods of market volatility.

38. (C) The percentage change in a securities' price for a 100 basis points change in yield.

Modified duration is a financial metric that measures the sensitivity of a bond's price to changes in interest rates. Specifically, it represents the approximate percentage change in the price of a security for every one hundred basis point change in its yield. It is derived from Macaulay duration and is a key tool used by risk managers.

39. (A) Both Statement I and Statement II are true.

The framework for Domestic Systemically Important Banks identifies institutions based on several indicators, including size, interconnectedness, and complexity. These banks are considered too important to fail due to the systemic damage their collapse would cause. Consequently, they are subjected to more intensive supervision and higher capital requirements to ensure they possess a greater capacity to absorb potential financial losses.

40. (B) The risk of systemic collapse arising from inter-institutional dependencies.

Systemic risk refers to the possibility that the failure of a single financial institution or a cluster of institutions can trigger a cascade of

failures throughout the entire financial system. This risk arises primarily from the high level of interconnectedness and interdependence between banks and other financial players. Such a collapse can cause severe disruption to the broader economy.

41. (C) Between adjacent zones - 50%

The market risk framework uses disallowances to account for basis and yield curve risks when netting positions. Within Zone 1, the disallowance is 40%, and within Zone 2 and 3, it is 30%. When netting between adjacent zones, such as Zones 1 and 2 or Zones 2 and 3, the disallowance is actually 40%. A 100% disallowance applies between non-adjacent zones.

42. (C) Rs. 9,000 Crores

To determine the absolute minimum total capital required, one multiplies the total risk-weighted assets by the minimum regulatory capital ratio. In this scenario, where the risk-weighted assets are one hundred thousand crores and the minimum ratio is nine percent, the required capital is nine thousand crores. This calculation excludes the additional capital conservation buffer, which would further increase the requirement.

43. (B) Exposure At Default (EAD) - Estimated amount of a facility likely to be drawn down in the event of default.

Exposure At Default represents the total estimated amount to which a bank is exposed at the moment a borrower defaults, including any undrawn facility amounts likely to be used. Probability of Default measures the likelihood over a one-year period, while Loss Given Default estimates the percentage of the exposure lost after recoveries. Maturity relates to the remaining time of the exposure.

44. (C) Rs. 250 lakhs

The total credit equivalent exposure is the sum of the outstanding fund-based balances and the credit equivalent amounts of off-balance sheet items. Here, the fund-based balance is one hundred lakhs. Adding the eighty-five lakhs for un-availed term loans and sixty-five lakhs for non-fund based facilities results in a total of two hundred and fifty lakhs. This represents the total exposure.

- 63.** (C) Reducing failure probability of institutions whose collapse would severely damage the real economy.

The primary reason for imposing higher capital requirements on Domestic Systemically Important Banks is to reduce their probability of failure. Because these institutions are deeply integrated into the financial system, their collapse would have devastating effects on the real economy. By holding extra capital, these banks have a larger buffer to absorb losses, thereby enhancing the overall stability of the financial environment.

- 64.** (A) Rs. 34.40 lakhs

The haircut-adjusted collateral value is calculated by applying volatility and currency haircuts to the original collateral. With a forty-lakh bond, the six percent collateral haircut and eight percent currency mismatch haircut are applied. Using the formula that subtracts the sum of these haircuts from the collateral value results in thirty-four point four lakhs. This adjusted figure represents the conservative value of protection.

- 65.** (C) Financial Stability Enforcement Group

The Basel Committee operates through several specialized sub-groups to develop and implement global standards. These include the Policy Development Group, the Accounting Experts Group, and the Supervision and Implementation Group. While the committee's work is vital for financial stability, there is no specific body named the Financial Stability Enforcement Group. Instead, enforcement is the responsibility of national regulatory authorities in each jurisdiction.

- 66.** (C) Assertion (A) is true, but Reason (R) is false. Basel III allows a portion of minority interest to be included in a group's Common Equity Tier 1 capital, provided the subsidiary is a bank and the capital supports its risks. However, minority interest in non-financial or non-bank subsidiaries is generally excluded from the regulatory capital of the consolidated group. This ensures that only capital with high loss-absorbing capacity is recognized.

- 67.** (D) To account for possible future fluctuations in the value of the exposure and the collateral occasioned by market movements.

In collateralised transactions, haircuts are essential for managing the risk that the value of the exposure or the collateral may change before a default is resolved. They adjust the market values downward for collateral and upward for exposures to account for potential price volatility. This conservative measurement ensures that banks maintain sufficient capital even if market conditions deteriorate and prices fluctuate significantly.

- 68.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Systemic risk is fundamentally linked to the interconnectedness of the financial system. When one bank fails, it cannot meet its obligations to other institutions, potentially causing a domino effect of defaults. This interdependence means that the stability of individual banks is tied to the health of the entire market. Therefore, the potential for widespread failure justifies the need for robust systemic risk management.

- 69.** (C) Imposing capital requirements to maximise the dividend payouts for shareholders.

Regulatory authorities focus on maintaining financial stability, protecting depositors, and ensuring fair competition among banks. Their primary goal is to manage systemic risk and prevent bank failures that could damage the economy. Imposing capital requirements is intended to build safety buffers and absorb potential losses, which often involves restricting dividend payouts during times of stress rather than seeking to maximize them.

- 70.** (B) II, III, IV, and V only

Credit Risk Mitigation rules specify standard haircuts for various risks, including an eight percent charge for currency mismatches. Unrated non-eligible instruments generally face a twenty-five percent haircut. Some government-backed instruments may qualify for a zero haircut. However, the first statement is often restricted as many regulators prefer standard supervisory haircuts over own-estimates to ensure consistency across the banking sector and simplify supervision.

54. (B) Rs. 21.89 lakhs

When the residual maturity of collateral is less than the maturity of the exposure, a maturity mismatch adjustment is required. The adjusted value is calculated using a formula that scales down the collateral value based on the ratio of the two maturities. In this instance, adjusting the haircut-adjusted collateral of thirty-four point four lakhs for the three-year exposure and two-year collateral results in twenty-one point eight-nine lakhs.

55. (D) Secured lending - 20 business days.

The Basel framework specifies minimum holding periods for calculating volatility adjustments. For repo-style transactions, the standard holding period is five business days. For other capital market transactions, it is ten business days. However, for standard secured lending transactions, the required minimum holding period is twenty business days. These periods reflect the time it might take to liquidate collateral during periods of stress.

56. (B) Rs. 5,500 Crores

The absolute minimum Common Equity Tier 1 capital is calculated by multiplying the total risk-weighted assets by the regulatory minimum CET1 ratio. With risk-weighted assets of one hundred thousand crores and a minimum ratio of five and a half percent, the bank must hold five thousand five hundred crores. This amount is the core capital required before considering any additional buffers.

57. (A) P-4, Q-3, R-2, S-1

Domestic Systemically Important Banks are categorized into buckets based on their systemic importance scores. Higher buckets carry higher additional Common Equity Tier 1 capital requirements. Bucket 4 requires an additional zero point eight percent, while Bucket 3 requires zero point six percent. Bucket 2 is assigned zero point four percent, and Bucket 1, the lowest tier for systemic importance, requires zero point two percent.

58. (A) P-2, Q-1, R-4, S-3

Under the standardized duration method for market risk, different time bands are assigned specific assumed changes in yield to reflect volatility. For positions of one month or less, the

assumed change is one point zero. For the one point nine to two point eight-year band, it is zero point eight. The four point three to five point seven-year band uses zero point seven.

59. (B) P-4, Q-1, R-2, S-3

Different risks within the Basel framework are measured using specific approaches. Credit risk can be assessed using the Internal Ratings Based Foundation approach. Market risk often utilizes the Standardised Duration Method. Operational risk may be measured through the Advanced Measurement Approach. Finally, Pillar 2 requirements are addressed through the Internal Capital Adequacy Assessment Process, which ensures banks manage their capital relative to risks.

60. (C) Rs. 843.75 Crores

To find the risk-weighted asset equivalent for operational risk, the capital charge is divided by the minimum capital requirement. Given a capital charge of sixty-seven point five crores and an eight percent requirement, dividing sixty-seven point five by zero point zero eight yields eight hundred and forty-three point seven-five crores. This conversion allows operational risk to be aggregated with other risk-weighted assets.

61. (A) III, II, I, IV

The timeline of banking regulation started with the establishment of the Basel Committee in 1974. This was followed by the original Concordat paper in 1975, which addressed the supervision of foreign bank establishments. Later, in 1992, minimum standards for international banking groups were published. Finally, the Market Risk Amendment to the Basel I Accord was introduced in 1996 to include trading book risks.

62. (B) Rs. 5.0 Crores

Vertical disallowance is calculated by applying a fixed percentage to the matched position within a maturity band. In this case, the matched position is one hundred crores, which is the smaller of the long and short positions. Using the standard five percent disallowance factor for vertical netting, the resulting charge is five crores. This accounts for basis risk within that specific band.

80. (C) Rs. 85 lakhs

The exposure for un-availed term loans is calculated by applying Credit Conversion Factors to the undisbursed portions based on their draw-down schedule. For the fifty lakhs to be drawn within a year, a twenty percent factor applies, equaling ten lakhs. For the one hundred and fifty lakhs scheduled after a year, a fifty percent factor applies, equaling seventy-five lakhs. The total exposure is eighty-five lakhs.

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- 71.** (B) Fees paid to outsourcing service providers.
For the Basic Indicator Approach, gross income is calculated before deducting most operating expenses, including fees paid for outsourced services. While items like realized profits from held-to-maturity securities and reversals of previous provisions are excluded to avoid distorting the core income figure, standard operating costs are not deducted. This ensures that the gross income remains a consistent proxy for the bank's operational scale.
- 72.** (A) I, II, III, and IV only
The Countercyclical Capital Buffer is activated based on the credit-to-GDP gap, with a lower threshold of three percentage points and an upper threshold of fifteen percentage points. The buffer increases as the gap grows, reaching a maximum of two and a half percent of risk-weighted assets. Contrary to the fifth statement, the requirement is not fixed at one percent but scales according to the gap.
- 73.** (C) Disclosures related to individual banks within groups would generally be required to be made by the parent bank.
Pillar 3 disclosures are designed to provide transparency at the top consolidated level of a banking group. While the parent bank is responsible for group-level data, individual banks within that group are generally still required to make their own disclosures if they are significant. The purpose of these requirements is to ensure that market participants can assess the risk profile of each institution.
- 74.** (A) I, II, III, and V only
Common Equity Tier 1 capital consists of the most stable and loss-absorbing forms of capital, such as common shares, statutory reserves, and capital reserves from asset sales. Stock surplus from share issues is also included. However, general provisions and loss reserves are usually classified as Tier 2 capital because they are intended to cover future, unidentified losses rather than being permanent equity.
- 75.** (B) The effects of CRM can be double counted if an issue-specific rating is used that already reflects that CRM.
The Basel framework explicitly prohibits the double counting of credit risk mitigation. If an

exposure already has an issue-specific rating that accounts for collateral or a guarantee, the bank cannot further reduce the capital requirement by applying additional CRM techniques to that same collateral or guarantee. This rule prevents an artificial reduction in capital charges and ensures that the risk is accurately measured.

- 76.** (B) I, II, and IV only
Pillar 2 is built on principles that require banks to assess their own capital adequacy and supervisors to evaluate those internal assessments. Furthermore, supervisors are expected to intervene early if they believe a bank's capital is likely to fall below minimum levels. However, the third statement is incorrect because supervisors expect banks to hold capital in excess of regulatory minimums for extra risks.
- 77.** (B) Rs. 83.11 lakhs
To find the final net exposure, the original exposure is adjusted for its haircut, and then the adjusted collateral value is subtracted. With a one hundred lakh exposure and a five percent haircut, the adjusted exposure is one hundred and five lakhs. Subtracting the maturity-adjusted collateral value of twenty-one point eight-nine lakhs results in a final net exposure for capital purposes of eighty-three point one-one lakhs.
- 78.** (D) Re-securitisations, irrespective of any credit ratings.
While cash, gold, and many investment-grade debt securities are eligible as financial collateral, re-securitisations are strictly excluded. These instruments are considered too complex and prone to high volatility during market stress, making them unreliable as a form of credit protection. The exclusion applies regardless of any external credit rating, as the risk of value loss is deemed too great for regulatory capital relief.
- 79.** (D) Rs. 450 Crores
In the Basic Indicator Approach, the average gross income is calculated using only the years where income was positive. Negative or zero gross income years are excluded from both the numerator and the denominator. Here, with income of four hundred and five hundred crores in two years and a loss in another, the average is calculated as nine hundred divided by two.

45. (A) P-4, Q-1, R-3, S-2

The Basel framework is organized into three pillars: Pillar 1 covers minimum capital requirements, Pillar 2 focuses on the supervisory review process, and Pillar 3 promotes market discipline through disclosures. Basel III introduced several enhancements to strengthen the system, including the capital conservation buffer. This structure ensures a comprehensive approach to managing credit, market, and operational risks within the industry.

46. (B) Rs. 65 lakhs

To calculate the credit equivalent amount for non-fund based facilities, the nominal amount is multiplied by the relevant Credit Conversion Factor. For the performance guarantee, fifty lakhs at a fifty percent factor equals twenty-five lakhs. For the financial guarantee, forty lakhs at a one hundred percent factor equals forty lakhs. Summing these results in a total credit equivalent exposure of sixty-five lakhs.

47. (A) P-4, Q-3, R-2, S-1

Credit Conversion Factors translate off-balance sheet exposures into credit equivalents. Unconditional take-out finance carries a one hundred percent factor as it represents a certain future exposure. Performance bonds have a fifty percent factor, reflecting their lower likelihood of being called compared to financial guarantees. Documentary credits carry twenty percent, while commitments that are unconditionally cancellable at any time are assigned zero percent.

48. (B) Rs. 67.5 Crores

Under the Basic Indicator Approach, the capital charge for operational risk is calculated by taking fifteen percent of the bank's average annual gross income. Given an average gross income of four hundred and fifty crores, applying the fifteen percent alpha factor results in a capital requirement of sixty-seven point five crores. This charge ensures the bank holds capital against operational failures.

49. (A) II, I, IV, V, III

The process for calculating risk-weighted assets begins with determining the adjusted exposure after accounting for netting. Next, allowable reductions from credit risk mitigation are identified. Following this, the applicable risk

weight is determined based on the counterparty's credit quality. The risk-weighted asset for each exposure is then calculated, and finally, these individual amounts are consolidated to find the total sum.

50. (C) Rs. 105 Crores

The total general market risk capital charge is calculated by taking the net position and adding any applicable disallowances. With a long position of two hundred crores and a short position of one hundred crores, the net position is one hundred crores. Adding the vertical disallowance of five crores for the matched portion results in a total capital charge of one hundred and five crores.

51. (D) Assessing bank soundness and capital adequacy against potential impacts of economic downturns.

Stress testing is a critical component of the Supervisory Review Process, used to evaluate how a bank's capital position would be affected by extreme but plausible economic scenarios. It helps supervisors and banks identify vulnerabilities that may not be apparent during normal market conditions. By simulating downturns, it ensures that institutions maintain sufficient capital to survive severe financial and economic shocks.

52. (B) Rs. 100 Crores

The net open position in a specific zone is determined by calculating the difference between the total long positions and total short positions within that zone. In this case, the bank has a long position generating a charge of two hundred crores and a short position generating one hundred crores. Subtracting the short from the long results in a net open position of one hundred crores.

53. (B) Internal procedure ensuring risk identification and capital maintenance relative to a bank's risk profile.

The Internal Capital Adequacy Assessment Process is a forward-looking tool used by banks to identify and measure all material risks they face. It ensures that the bank's capital levels are commensurate with its unique risk profile and future business strategy. This process is reviewed by supervisors under Pillar 2 to verify that the bank has a robust framework for capital adequacy.

CHAPTER 14

Market Risk

Oct/Nov 2023

1. The Risk Taking Unit at a bank operates a portfolio where market risk is not measured on a daily basis. To ensure compliance with the approved limits for factor sensitivities, what is the mandatory operational requirement for this unit?
- (A) The unit must liquidate the portfolio at the end of every week.
 - (B) The unit must seek daily approval from the Board of Directors for any transaction.
 - (C) Implementing active procedures to ensure all trading activities remain within approved risk limits
 - (D) The unit must convert all asset holdings into cash reserves.

May/June 2007

2. Which of the following statements correctly represents the concept of Macaulay's Duration?
- (A) It represents the worst-case loss of a bond at a 99% confidence level over one day.
 - (B) The average time a bondholder waits to receive the present value of cash flows.
 - (C) It measures the historical price volatility of an equity portfolio over the last 250 working days.
 - (D) It isolates the short-term impact on a portfolio's value from a series of predefined exchange rate moves.

Oct/Nov 2014

3. If an investor with a capital of Rs. 10,000 leverages his capital by borrowing 9 times his capital to invest in shares, what is the impact of a 5% drop in the share price on his original capital, excluding transaction and borrowing costs?
- (A) Capital is reduced by 5%
 - (B) Capital is reduced by 10%
 - (C) Capital is reduced by 45%
 - (D) Capital is reduced by 50%

May/June 2019

4. Which of the following statements incorrectly describes the use or limitation of stress tests?
- (A) Stress testing results help the management to be forward-looking in managing disasters mooted by market factors.
 - (B) A well-understood limitation of stress testing is the lack of probabilities attached to the outcomes.
 - (C) Stress testing is used for managing funding risk and determining capital charges on trading desks' positions.
 - (D) Simple technique avoiding complex choices regarding which risk factors to stress or combine.

Oct/Nov 2005

5. An investor has raised a capital of Rs. 10,000 and is permitted to borrow 9 times his capital. He fully invests the combined amount in the shares of ABC Ltd. at Rs. 100 per share. If the share price drops by 5%, causing his capital to fall to Rs. 5,000, and the market anticipates a further fall in price, what immediate risk forces the investor to liquidate holdings at a potentially lower price to repay his borrowings?
- (A) Systemic Risk
 - (B) Settlement Risk
 - (C) Interest Rate Risk
 - (D) Asset Liquidity Risk

May/June 2021

6. Consider the following statements regarding Conditional VaR:
- I. It is also called Expected Shortfall (ES).
 - II. It considers severe losses of the financial system that lie strictly within the assumed VaR confidence level.
 - III. It ensures capturing of a portion of tail risk which falls beyond the regular VaR measure.
- Which of the above statement(s) is/are correct?
- (A) Only I and II
 - (B) Only I and III
 - (C) Only II and III

correlation that is not perfect, the price volatility of the portfolio would still be exactly zero.

Oct/Nov 2009

- 21.** Consider the following functions:
- I. Product pricing for deposits and advances
 - II. Articulating the interest rate view of the bank
 - III. Setting guidelines for market risk management and reporting
 - IV. Monitoring the liquidity position of the bank and industry
 - V. Balance sheet management
- Which of the above combination of functions correctly falls under the responsibility of the Asset-Liability Management Committee (ALCO)?
- (A) Only I, II, III, and V
 - (B) Only I, II, IV, and V
 - (C) Only II, III, IV, and V
 - (D) I, II, III, IV, and V

May/June 2020

- 22.** Consider a risk mitigation strategy where a portfolio manager holding a fixed rate bond enters into an Interest Rate Swap (IRS) being long on a variable rate of interest:
- I. As market interest rates move up, the bond price will come down, causing a loss.
 - II. As market interest rates move up, the IRS valuation will decrease.
 - III. Higher interest receipts under the IRS offset the losses on the bond price.
 - IV. This strategy reduces portfolio volatility.
- Which of the above statement(s) is/are correct?
- (A) Only I, II, and III
 - (B) Only I, III, and IV
 - (C) Only II, III, and IV
 - (D) I, II, III, and IV

Oct/Nov 2015

- 23.** Match the organisational bodies in List I with their corresponding responsibilities in List II.
- List I: (Organisational Bodies)
- P. Board of Directors
 - Q. Risk Management Committee
 - R. Asset-Liability Management Committee (ALCO)
 - S. Middle Office
- List II: (Responsibilities)
1. Responsible for protecting and improving

the NIM of the bank

2. Independently validates the prices in respect of structured products
 3. Articulates market risk management policies and aggregate risk limits
 4. Ensures robustness of measurement of risk models
- (A) P-3, Q-4, R-1, S-2
 - (B) P-1, Q-2, R-3, S-4
 - (C) P-4, Q-1, R-2, S-3
 - (D) P-2, Q-3, R-4, S-1

May/June 2013

- 24.** What is the most appropriate role of risk managers when dealing with stress test results?
- (A) Summarizing risk data to help management align risk-taking with the firm's risk appetite
 - (B) Ignoring the specific results if they conflict with the historical VaR calculations performed daily
 - (C) Solely using the reported results for determining the internal transfer pricing for retail deposits
 - (D) Using the results to completely replace the standard daily mark-to-market revaluation process

Oct/Nov 2021

- 25.** Arrange the following sub-divisions of the market risk management process in their correct sequential flow:
1. Risk Mitigation
 2. Risk Identification
 3. Risk Monitoring and Control
 4. Risk Measurement
- (A) 2, 4, 3, 1
 - (B) 2, 3, 4, 1
 - (C) 4, 2, 1, 3
 - (D) 1, 4, 3, 2

May/June 2024

- 26.** Arrange the following procedural steps for conducting a stress test in the correct chronological order:
1. Determine the time frame
 2. Identify market parameters to stress
 3. Apply on the portfolio to assess the impact
 4. Determine the quantum of stress
- (A) 2, 4, 1, 3
 - (B) 2, 1, 4, 3
 - (C) 4, 2, 1, 3
 - (D) 1, 2, 4, 3

(D) Asset Liquidity Risk — General liquidity crunch affecting all asset classes in the market

May/June 2025

14. Consider the following requirements for Risk Monitoring:

- I. Rates used at inception or for periodic marking to market must be independently verified.
- II. Financial Models used for revaluations must be independently tested and certified.
- III. Stress tests must be performed preferably annually with random, undocumented changes.

Which of the above statement(s) is/are correct?

- (A) Only I and II
- (B) Only I and III
- (C) Only II and III
- (D) I, II, and III

Oct/Nov 2019

15. Consider the following statements regarding market and counterparty risks:

- I. Under a hold-to-maturity view, the potential future values over their life are regarded as the credit risk exposure.
- II. Current credit risk exposure is exactly equal to the historical purchase value of the instrument.
- III. As the value of a financial instrument varies depending upon market factors, the credit risk amount also varies.
- IV. Settlement risk may lead to systemic risk, prompting authorities to implement systems like RTGS.

Which of the above statement(s) is/are correct?

- (A) Only I, II, and III
- (B) Only I, III, and IV
- (C) Only II, III, and IV
- (D) I, II, III, and IV

May/June 2009

16. Which of the following is not a strategy for managing trading liquidity risk?

- (A) Avoiding a large market share in any given type of asset
- (B) Avoiding infrequently traded instruments
- (C) Avoiding one-sided liquidity in the market
- (D) Avoiding instruments with short, highly liquid tenors

Oct/Nov 2011

17. A bank's trading desk holds a large volume of derivative contracts intended to hedge other elements of the trading book. Due to a sudden default by a major counterparty, the exchange of future funds flows is compromised. What specific risk interacts with the market risk of these derivatives in determining the liquidation value?

- (A) Asset Liquidation Risk
- (B) Credit Risk
- (C) Settlement Risk
- (D) Operational Risk

May/June 2010

18. Which of the following statements correctly identifies the impact of using an established exchange as a central counterparty?

- (A) It increases the downside variability in net cash flow.
- (B) It converts all asset liquidity risk into market liquidity risk.
- (C) It reduces the counterparty risk very substantially.
- (D) It eliminates the need to calculate Value at Risk for the portfolio.

Oct/Nov 2024

19. Which of the following is not included in the standard Market Risk Management organisation structure of a bank?

- (A) The Central Counterparty Clearing Corporation
- (B) The Board of Directors
- (C) The Asset-Liability Management Committee (ALCO)
- (D) The Middle Office

May/June 2017

20. Which of the following statements regarding correlation measures in risk mitigation is incorrect?

- (A) Prices of two financial instruments that have perfect negative correlation move exactly in the opposite direction.
- (B) A portfolio long on a stock and short in the stock future of that same stock utilizes negative correlation to mitigate market risk.
- (C) Interest rate swaps can be used to mitigate portfolio volatility caused by fixed rate bonds.
- (D) If the financial instruments have negative

(D) Simple Sensitivity Test

May/June 2021

48. Consider the following statements regarding liquidity risks:

- I. Asset liquidation risk refers to a situation where a specific asset faces a lack of trading liquidity, even though there is good liquidity for other asset classes.
- II. Market liquidation risk refers to a situation when there is a general liquidity crunch in the market, affecting trading liquidity adversely.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2010

49. Which stress testing technique assesses risks by identifying the most potentially damaging combination of moves of market risk factors, though risk managers tend not to rely on it for setting exposure limits systematically due to its arbitrary character?
- (A) Scenario Analysis
 - (B) Maximum Loss
 - (C) Historical Simulation
 - (D) Simple Sensitivity Test

May/June 2005

50. How is trading liquidity defined in the context of market operations?
- (A) The ability to settle inter-bank transactions through a real-time gross settlement system
 - (B) The ability to hedge long-term equity positions using exotic derivatives over an extended period
 - (C) The ability to transact in markets at fair prices without significantly impacting price or market attention
 - (D) The capacity of an asset to yield positive returns when the general market undergoes a liquidity trap

Oct/Nov 2022

51. Consider the following methods to achieve market risk control through boundary values imposed on risks:
- I. System and procedures to unbundle products and transactions

- II. Policy guidelines limiting roles and authority
- III. Defined policy for mark-to-market
- IV. Ignoring portfolio size and mix guidelines to maximize returns

Which of the above statement(s) is/are correct?

- (A) Only I, II, and III
- (B) Only II, III, and IV
- (C) Only I, III, and IV
- (D) I, II, III, and IV

May/June 2018

52. Which of the following proprietary positions is not presently permitted in the trading book of banks?
- (A) Foreign Exchange
 - (B) Equity
 - (C) Derivatives held for Trading
 - (D) Commodities

Oct/Nov 2016

53. Which of the following pairs is incorrectly matched regarding the approaches to calculating VaR?
- (A) Monte Carlo simulation — User imposes views and experience by making assumptions about market structures
 - (B) Correlation method — Combining component sensitivities with volatilities and correlation
 - (C) Simple Sensitivity Test — Isolates short-term impact of predefined moves in a particular factor
 - (D) Historical simulation — Relies heavily on a variance/covariance matrix to predict future historical movements

May/June 2014

54. Which of the following statements regarding credit risk and market pricing is incorrect?
- (A) Markets value the credit risk of issuers and borrowers, which reflects in prices.
 - (B) Credit rating indicates the risk level and is factored in as an add-on to the risk-free rate.
 - (C) The higher the risk level, the lower the spread over the risk-free rate.
 - (D) Downward migration of a credit rating increases the spread and results in a decline in the price of the instrument.

Oct/Nov 2008

27. Consider the following statements regarding the sensitivity measure of risk:
- Sensitivity considers the impact of all parameters changing simultaneously in the market.
 - The measure of sensitivity does not remain constant for all values of the variable.
- Which of the above statement(s) is/are correct?
- Only I
 - Only II
 - Both I and II
 - Neither I nor II

May/June 2006

28. Match the approaches to calculating Value-at-Risk (VaR) in List I with their characteristic features in List II.
- List I: (Approaches)
- Correlation method
 - Historical simulation
 - Monte Carlo simulation
 - Conditional VaR (Expected Shortfall)
- List II: (Features)
- Uses a sample of randomly generated price scenarios where the user makes assumptions about market structures
 - A deterministic approach using a variance/covariance matrix of volatilities and correlation
 - Captures a portion of tail risk by averaging the values that fall beyond the VaR
 - Calculates change using actual past movements without needing a variance/covariance matrix
- P-4, Q-1, R-3, S-2
 - P-2, Q-4, R-1, S-3
 - P-1, Q-2, R-4, S-3
 - P-3, Q-4, R-2, S-1

Oct/Nov 2017

29. A bank's Middle Office independently reviews the treasury department's trades. It discovers that a trader deviated from the directed procedures and safeguards for a standard product. What is the immediate requirement to address the added risk content of this exposure?
- Immediate liquidation of the exposure regardless of the market price
 - Corporate level clearance based on risk quantification and defined risk-return characteristics

- Complete redesign of the bank's VaR models to incorporate the deviation
- Transferring the exposure to the Asset-Liability Management Committee for balance sheet funding

May/June 2008

30. Match the characteristics of risk reporting in List I with their sequence of importance for senior management reports in List II.
- List I: (Reporting Characteristics)
- Regular and in time
 - Reasonably accurate
 - Including highlights of portfolio risk concentrations & exceptional events
 - Containing written commentary
- List II: (Order of Importance)
- Fourth in order of importance
 - Third in order of importance
 - Second in order of importance
 - First in order of importance
- P-4, Q-3, R-2, S-1
 - P-1, Q-2, R-3, S-4
 - P-3, Q-4, R-1, S-2
 - P-2, Q-1, R-4, S-3

Oct/Nov 2013

31. Consider the following statements regarding Basis Point Value (BPV):
- It is the change in value due to a 1 basis point (0.01%) change in the market yield.
 - A higher BPV of a bond indicates lower risk associated with the bond.
 - BPV changes with the remaining maturity of the bond.
 - On the day of maturity, the BPV of a bond will be zero.
- Which of the above statement(s) is/are correct?
- Only I, II, and III
 - Only I, III, and IV
 - Only II, III, and IV
 - I, II, III, and IV

May/June 2015

32. What is the most appropriate role of risk measurement within the function of controlling and monitoring market risk?
- It relies solely on exponential moving averages to dictate board policies.
 - It replaces the function of the Asset-Liability Management Committee.
 - It guarantees that net cash flow will always

May/June 2017

62. Match the options terminology in List I with its function in List II.

List I: (Options Terminology)

- P. Option Premium
- Q. Long position on Call Option
- R. Long position on Put Option
- S. Strike Rate

List II: (Functions)

- 1. Confers a right to buy the underlying instrument
- 2. The predetermined price at which the underlying instrument is bought or sold
- 3. Confers a right to sell the underlying instrument
- 4. The upfront cost paid to acquire a right without the obligation

- (A) P-1, Q-2, R-3, S-4
- (B) P-4, Q-1, R-3, S-2
- (C) P-2, Q-4, R-1, S-3
- (D) P-3, Q-1, R-4, S-2

Oct/Nov 2009

63. Which instrument provides the framework for operating new or non-standard products on a temporary basis while a full Market Risk Product Programme is being prepared?

- (A) Value at Risk Mandate
- (B) Stress Testing Scenario Report
- (C) Product Transaction Memorandum
- (D) Default Risk Covenant

May/June 2020

64. Consider the following statements regarding the models of analysis used in market risk monitoring:

- I. The models should be subject to model assumption review on a periodic basis.
- II. Unauthorized or unintended changes should be permitted if they improve the model's predictive accuracy temporarily.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2015

65. Which of the following pairs is incorrectly matched regarding market risk measurement parameters?

- (A) Sensitivity — Captures deviation of market

price due to unit movement of a single market parameter

- (B) Downside Potential — Captures the possible losses only and ignores the profit potential
- (C) Modified Duration — Macaulay's duration discounted by 1 period yield to maturity
- (D) Basis Point Value (BPV) — Change in value due to 10 basis points (0.10%) change in the market yield

May/June 2013

66. According to the explicit ways stress tests are used to influence decision-making, which of the following is not one of them?

- (A) Managing funding risk
- (B) Providing a check on modelling assumptions
- (C) Determining capital charges on trading desks' positions
- (D) Eliminating the need for the Board of Directors' oversight

Oct/Nov 2021

67. Consider the following components used to control market risk keeping variations within boundary values:

- I. Limit structure and approval process
- II. Guidelines on portfolio size and mix
- III. Performance Measurement and Resource Allocation
- IV. System for estimating portfolio risk under normal and stressed situations
- V. Limit monitoring and reporting

Which combination correctly lists the tools used to achieve this control?

- (A) Only I, II, III, and V
- (B) Only I, II, IV, and V
- (C) Only II, III, IV, and V
- (D) I, II, III, IV, and V

May/June 2024

68. Who proposed the concept of Duration as a means of describing a bond's price sensitivity to yield change with a single number?

- (A) Harry Markowitz
- (B) John Maynard Keynes
- (C) Fischer Black
- (D) Frederick Macaulay

Oct/Nov 2008

69. Consider the following statements regarding the validation of models of analysis:

- I. They must be duly approved by the Risk

Oct/Nov 2025

40. A bank holds a significant proprietary position in government bonds. To evaluate how these bonds would perform under severely stressed market liquidity constraints, the risk group constructs a scenario mimicking a previous historical market crash. This approach primarily exemplifies which stress testing technique?
- (A) Scenario Analysis
 - (B) Extreme Value Theory
 - (C) Historical Simulation for VaR
 - (D) Simple Sensitivity Test

May/June 2012

41. According to the standard normal distribution table for confidence intervals, what is the corresponding Standard Deviation (Z-score) for a 99% level of confidence?
- (A) 1.65
 - (B) 2
 - (C) 2.326
 - (D) 3

Oct/Nov 2006

42. What is the definition of market risk in the context of a trading portfolio?
- (A) The risk of loss arising from asset-liability maturity mismatches over the lifecycle of an instrument
 - (B) The risk of mark-to-market losses on the trading portfolio due to price fluctuations during liquidation
 - (C) The risk of market losses arising from operational failures, including not monitoring the market with due care
 - (D) The risk of an asset becoming untradable due to a general liquidity crunch in the domestic banking system

Oct/Nov 2023

43. A trader holds Rs. 1,000,000 (face value) of a 5-year bond. The BPV of the bond is Rs. 2,000 per Rs. 1 crore face value. If the market yield on this bond declines by 8 basis points, what is the resulting profit or loss for the trader?
- (A) Profit of Rs. 16,000
 - (B) Loss of Rs. 16,000
 - (C) Profit of Rs. 1,600
 - (D) Loss of Rs. 1,600

May/June 2007

44. Which of the following is not a distinct risk faced by an investor taking an exposure on a security traded in the market?
- (A) Risk of adverse movement in the price
 - (B) Risk of reduced liquidity in the market for a specific security
 - (C) Risk of technical breakdowns within the exchange's trading platform
 - (D) Risk of poor market liquidity

Oct/Nov 2014

45. Which of the following statements correctly defines back testing?
- (A) It is the process of generating random price scenarios to estimate future capital requirements.
 - (B) Continuous comparison of model-based VaR against actual portfolio performance.
 - (C) It isolates the short-term impact on a portfolio's value from predefined moves in exchange rates.
 - (D) It averages the values of severe losses that fall beyond the calculated VaR.

May/June 2019

46. Which of the following statements correctly distinguishes pure market risk from operational risk in the context of portfolio monitoring?
- (A) Any deficiency in monitoring the market portfolio resulting in market values deviating is classified as a pure market risk.
 - (B) Operational risk is generated exclusively by changes in market parameters like interest rates and equity indexes.
 - (C) Market losses caused by lack of care in monitoring rather than price movements are operational risks.
 - (D) A prolonged liquidation period automatically converts pure market risk into operational risk.

Oct/Nov 2005

47. A portfolio manager applies a test that isolates the short-term impact on the portfolio's value using a series of predefined exchange rate shocks of +/- 2%, 4%, 6%, and 10%, while keeping all other market factors constant. Which stress testing technique is being applied?
- (A) Scenario Analysis
 - (B) Maximum Loss
 - (C) Extreme Value Theory

have a positive upside potential.

- (D) It involves setting up of limits and triggers, monitoring them, and valuing the portfolio.

Oct/Nov 2012

33. Consider the following statements regarding downside potential and VaR:

- I. Downside risk captures possible losses only and ignores profit potential.
- II. VaR answers the question "How much can we expect to lose?" under normal trading conditions.
- III. A bank having a 1-day VaR of Rs. 10 crore with 99% confidence implies there is a 99% chance the daily loss will exceed Rs. 10 crore.

Which of the above statement(s) is/are correct?

- (A) Only I and II
- (B) Only II and III
- (C) Only I and III
- (D) I, II, and III

May/June 2011

34. Consider the following factors to avoid in order to manage the risk of trading liquidity:

- I. Large market share in any given type of asset
- II. Infrequently traded instruments
- III. Instruments with unusual tenors
- IV. One-sided liquidity in the market
- V. High liquidity environments

Which of the above statement(s) is/are correct regarding factors that should be avoided?

- (A) Only I, II, III, and V
- (B) Only I, II, III, and IV
- (C) Only II, III, IV, and V
- (D) I, II, III, IV, and V

Oct/Nov 2020

35. A trader holds a portfolio of bonds with a calculated modified duration of 2.57. If the yield on these bonds suddenly falls from 8% to 7%, what is the approximate percentage change in the price of the bonds?

- (A) The price would go down by 2.57%
- (B) The price would go up by 2.57%
- (C) The price would go down by 1.00%
- (D) The price would go up by 1.00%

May/June 2022

36. A market risk analyst needs to compute the VaR limit for an equity portfolio. The bank's

policy mandates a confidence level of 95.50%. According to the standard normally distributed curve, what is the corresponding Standard Deviation score to be used in the calculation?

- (A) 1
- (B) 1.65
- (C) 2
- (D) 2.326

May/June 2016

37. What is the document that defines procedures, limits, and controls for all aspects of a standard product, including market risk measurement at both the individual and aggregate portfolio levels?

- (A) Operational Risk Directive
- (B) Default Risk Matrix
- (C) Stress Testing Scenario Code
- (D) Product Programme

May/June 2023

38. Consider the following strategies using sensitivity measures for mitigating risk in a portfolio:

- I. Portfolio duration can be reduced by selling higher duration instruments.
- II. Portfolio duration can be reduced by adding low duration instruments.
- III. Portfolio duration can be increased by selling low duration instruments.

Which of the above statement(s) is/are correct as valid methods for altering portfolio duration?

- (A) Only I and II
- (B) Only I and III
- (C) Only II and III
- (D) I, II, and III

Oct/Nov 2018

39. Consider the following statements regarding estimating volatility for VaR:

- I. In the exponential moving average method, volatility estimates rise faster to shocks and decline gradually.
- II. In the arithmetical moving average method, volatility is computed from historical time series data.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2007

55. A fund manager wishes to limit the downside risk of a highly valued equity portfolio without selling the stocks. The manager decides to purchase a right to sell the underlying instruments at a predetermined strike rate. The manager pays an upfront cost for this protection. Which financial instrument is the manager utilizing for risk mitigation?
- (A) Interest Rate Swap
(B) Long position on a Put Option
(C) Long position on a Call Option
(D) Matched principal brokering

May/June 2025

56. Consider the following elements:
- Relevant to the current position
 - Considers changes in all relevant market rates
 - Examines potential regime shifts (whether parameters hold or breakdown)
 - Considers market illiquidity
 - Considers the interplay of all risks, particularly market and credit risk
- Which combination of elements describes what makes a "Good Stress Test"?
- (A) Only I, II, III, and IV
(B) Only II, III, IV, and V
(C) Only I, II, IV, and V
(D) I, II, III, IV, and V

Oct/Nov 2019

57. Read the following Assertion (A) and Reason (R) regarding liquidity risk:
Assertion (A): Market liquidity risk is identical to funding liquidity risk.
Reason (R): Funding liquidity risk relates to the bank's ability to meet its financial obligations as they fall due.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2009

58. Read the following Assertion (A) and Reason (R) regarding OTC deals:
Assertion (A): Risk mitigation strategies

involving a counterparty in OTC deals eliminate counterparty risk entirely.

Reason (R): In OTC deals, counterparty risk depends on the risk level associated with the specific party to the contract.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2011

59. Which of the following correctly identifies the four key parts into which market risk management processes are sub-divided?
- (A) Risk Assessment, Risk Calibration, Risk Pricing, Risk Dissemination
(B) Risk Identification, Risk Measurement, Risk Monitoring and Control, Risk Mitigation
(C) Risk Aggregation, Risk Hedging, Risk Capitalization, Risk Trading
(D) Risk Modeling, Risk Evaluation, Risk Diversification, Risk Elimination

May/June 2010

60. A bank holds a portfolio containing two bonds, A and B, with BPVs of Rs. 675 and Rs. 205 respectively. The weighted average portfolio BPV is 440. To mitigate the risk and reduce the portfolio BPV to 361.7, the bank decides to:
- (A) Add another Bond B to the portfolio
(B) Sell Bond B and purchase a highly volatile equity stock
(C) Add another Bond A to the portfolio
(D) Double the holdings of Bond A and sell Bond B

Oct/Nov 2024

61. What is the designated function of the Middle Office in a bank's market risk organisation?
- (A) Establishing operational prudential limits for the pricing of retail deposits
(B) Clearly articulating the daily interest rate view of the bank's committee
(C) Independent monitoring and reporting of the treasury's market risk profile
(D) Conducting matched principal brokering and specialized market making activities

(D) I, II, and III

Oct/Nov 2010

7. Which of the following does not represent a component of the trading book of a bank?
- (A) Proprietary positions in financial instruments like debt securities and equity
 - (B) Long-term strategic equity investments held in subsidiaries until maturity
 - (C) Positions taken in order to hedge other elements of the trading book
 - (D) Positions in financial instruments arising from matched principal brokering and market making

May/June 2005

8. Read the following Assertion (A) and Reason (R) regarding Extreme Value Theory (EVT):
 Assertion (A): The Extreme Value Theory (EVT) method can accommodate skewed and fat-tailed probability distributions.
 Reason (R): EVT focuses only on the tails of a probability distribution rather than the entire distribution.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2022

9. Read the following Assertion (A) and Reason (R) regarding credit risk on derivatives:
 Assertion (A): Credit risk on a derivative arises when the mark-to-market value is positive, implying a receivable from the counterparty.
 Reason (R): When the mark-to-market value is negative, the counterparty is exposed to credit risk as they carry a receivable.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2018

10. In market risk mitigation, why is the reduction of downside variability in net cash flow often viewed as a trade-off?
- (A) Because it significantly increases the regulatory capital requirement
 - (B) Because it simultaneously reduces the upside potential or profit potential
 - (C) Because it eliminates all counterparty risks inherent in the portfolio
 - (D) Because it forces the bank to shift all investments into commodities

Oct/Nov 2016

11. Consider the following statements regarding the consequences of liquidation risk arising from a lack of trading liquidity:
- I. It results in an adverse change in market prices.
 - II. It leads to the inability to liquidate a position at a fair market price.
 - III. It prevents any large price changes caused by the liquidation of a position.
- Which of the above statement(s) is/are correct?
- (A) Only I and II
 - (B) Only II and III
 - (C) Only I and III
 - (D) I, II, and III

May/June 2014

12. The Middle Office of a bank is reviewing the models used for revaluations and income recognition. According to the market risk management framework, what is the minimum frequency for these models to be validated by a reputed external agency?
- (A) Once every quarter
 - (B) Once in a year
 - (C) Once every two years
 - (D) Once every five years

Oct/Nov 2007

13. Which of the following pairs correctly matches the risk with its description?
- (A) Market Liquidity Risk — Risk arising due to asset-liability maturity mismatch
 - (B) Settlement Risk — Risk arising when one transacting party defaults in completing the settlement
 - (C) Credit Risk — Risk of adverse deviations in the mark-to-market value during the liquidation period

Policy Committee.

- II. They must be fully documented financial models.
- III. They must be validated by the designated person to ensure the algorithm is appropriate and accurate.
- IV. They are exempt from external agency validation if the internal Middle Office has approved them.

Which of the above statement(s) is/are correct?

- (A) Only I, II, and III
- (B) Only I, III, and IV
- (C) Only II, III, and IV
- (D) I, II, III, and IV

May/June 2006

70. Match the approaches to calculating Value-at-Risk (VaR) in List I with their characteristic features in List II.

List I: (Approaches)

- P. Correlation method
- Q. Historical simulation
- R. Monte Carlo simulation
- S. Conditional VaR (Expected Shortfall)

List II: (Features)

- 1. Uses a sample of randomly generated price scenarios where the user makes assumptions about market structures
 - 2. A deterministic approach using a variance/covariance matrix of volatilities and correlation
 - 3. Captures a portion of tail risk by averaging the values that fall beyond the VaR
 - 4. Calculates change using actual past movements without needing a variance/covariance matrix
- (A) P-4, Q-1, R-3, S-2
 - (B) P-2, Q-4, R-1, S-3
 - (C) P-1, Q-2, R-4, S-3
 - (D) P-3, Q-4, R-2, S-1

Oct/Nov 2017

71. Consider the following characteristics of a risk report directed to the CEO:
- I. Reasonably accurate
 - II. Concise
 - III. Regular and in time
 - IV. Containing written commentary
 - V. Including highlights of portfolio risk concentrations & exceptional events
- Which of the above statement(s) is/are correct as stipulated for senior management reports?

- (A) Only I, II, III, and IV
- (B) Only I, III, IV, and V
- (C) Only II, III, IV, and V
- (D) I, II, III, IV, and V

May/June 2008

72. Which of the following is not a limitation or characteristic of Value at Risk (VaR)?
- (A) VaR provides a predicted worst-case scenario regardless of confidence levels.
 - (B) VaR does not measure losses under any particular market conditions.
 - (C) VaR relies on estimated volatility and correlations from normal market circumstances.
 - (D) VaR cannot measure risk under abnormal conditions that lie beyond the assumed confidence level.

Oct/Nov 2013

73. A bank implements a new fully documented financial model to monitor price risk. The model algorithm has been validated internally by a designated person. According to the risk monitoring and control framework, what further validation is explicitly required at least once in a year?
- (A) Validation by a reputed external agency
 - (B) Validation by the Clearing Corporation
 - (C) Validation by the retail branch managers
 - (D) Validation by the counterparty of all derivatives

May/June 2015

74. Read the following Assertion (A) and Reason (R) regarding security duration:
- Assertion (A): The longer the duration of a security, the greater will be the price sensitivity to yield changes.
- Reason (R): Bond price changes can be estimated by multiplying the modified duration by the yield change.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

9. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Credit risk in derivative transactions is asymmetric and depends on the mark-to-market value. A positive value represents a receivable, exposing the holder to the counterparty's potential default. Conversely, a negative value exposes the counterparty to credit risk. While both statements are factually true regarding the nature of exposure, the latter does not logically explain the former's existence.

10. (B) Because it simultaneously reduces the upside potential or profit potential

Mitigating market risk typically involves reducing the volatility of net cash flows. However, this stabilization creates a trade-off where the potential for significant gains is also diminished. By limiting the exposure to price fluctuations, the bank protects itself from severe losses but simultaneously sacrifices the opportunity to profit from favorable market movements, reflecting the risk-return balance in financial management.

11. (A) Only I and II

Liquidity risk arises when a position cannot be closed at a fair market price due to insufficient market depth. This lack of trading liquidity often leads to adverse changes in market prices as the seller attempts to exit. Consequently, the investor faces the inability to liquidate holdings efficiently, resulting in significant deviations from the expected mark-to-market value.

12. (B) Once in a year

Standard market risk management frameworks require that revaluation and income recognition models undergo independent validation. A reputed external agency must perform this verification at least once a year. This annual requirement ensures the ongoing accuracy and integrity of the algorithms used, accounting for changing market conditions and preventing undetected errors in the bank's financial reporting and risk assessments.

13. (B) Settlement Risk — Risk arising when one transacting party defaults in completing the settlement

Settlement risk occurs during the exchange of funds or assets when one party fulfills their

obligation but the counterparty fails to do so. This temporal lag in transaction completion creates a direct exposure. It is a critical component of operational and credit risk management, particularly in high-value foreign exchange or securities markets where timing differences between global centers exist.

14. (A) Only I and II

Effective risk monitoring necessitates independent verification of market rates used for marking positions to market. Additionally, the financial models employed for revaluations must be rigorously tested and certified. Stress tests, however, should be performed regularly using documented, systematic scenarios rather than random or undocumented changes to ensure consistent and reliable management information regarding potential extreme portfolio impacts.

15. (B) Only I, III, and IV

Credit risk exposure on financial instruments varies according to market factors, as the potential future value determines the amount at risk. Settlement risk can escalate into systemic risk, necessitating robust systems like Real-Time Gross Settlement. While potential future values represent life-long exposure, current credit risk is determined by current mark-to-market values rather than historical purchase costs.

16. (D) Avoiding instruments with short, highly liquid tenors

Managing trading liquidity risk involves ensuring that positions can be exited quickly without significant price impact. Strategies include avoiding large market shares, infrequently traded assets, or one-sided markets. Conversely, instruments with short, highly liquid tenors are desirable because they facilitate easy liquidation. Therefore, avoiding such liquid instruments would be counterproductive to managing liquidity risk effectively in trading.

17. (B) Credit Risk

When a major counterparty defaults on derivative contracts, the bank is exposed to credit risk. This risk interacts directly with the market risk of the underlying positions. The liquidation value of these derivatives becomes dependent on the counterparty's ability to fulfill obligations. Consequently, the creditworthiness of the

ANSWERS

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1. (C) Implementing active procedures to ensure all trading activities remain within approved risk limits
When market risk is not measured daily, the bank must implement robust active procedures. These procedures ensure all trading activities adhere to the predefined risk limits established for factor sensitivities. This operational mandate safeguards the bank by maintaining exposure within approved thresholds, preventing unauthorized risk accumulation and ensuring regulatory compliance through continuous internal control mechanisms.
2. (B) The average time a bondholder waits to receive the present value of cash flows.
Macaulay's Duration measures the weighted average time until a bondholder receives the present value of all future cash flows, including principal and interest. It serves as a fundamental metric for assessing interest rate sensitivity. By calculating the time to recover the investment, it provides a standardized way to compare the interest rate risk of various debt securities.
3. (D) Capital is reduced by 50%
Leveraging capital by borrowing nine times results in a total investment ten times the original capital. A five percent drop in the total portfolio value equates to fifty percent of the investor's initial capital. This magnifying effect demonstrates the significant risk associated with high leverage, where small price movements in the underlying assets lead to substantial losses on equity.
4. (D) Simple technique avoiding complex choices regarding which risk factors to stress or combine.
Stress testing is actually a complex analytical technique requiring sophisticated choices regarding which specific risk factors to stress or combine. It aims to evaluate the impact of exceptional but plausible events. Unlike the suggested simplicity, it involves rigorous modeling of extreme scenarios, such as market crashes or regime shifts, which are not captured by standard risk measures.
5. (D) Asset Liquidity Risk
Asset liquidity risk occurs when an investor is forced to liquidate holdings at a lower price due to a lack of market buyers or anticipated further price declines. In leveraged scenarios, a margin call or capital erosion triggers immediate selling requirements. The inability to exit positions at fair value during distress exemplifies how specific asset illiquidity impacts overall capital stability.
6. (B) Only I and III
Conditional Value at Risk, also known as Expected Shortfall, provides a more comprehensive measure by capturing tail risk beyond the standard VaR threshold. It calculates the average loss in scenarios where the loss exceeds the VaR confidence level. This metric addresses the limitation of traditional VaR by focusing on extreme losses occurring in the distribution's tail.
7. (B) Long-term strategic equity investments held in subsidiaries until maturity
The trading book consists of positions in financial instruments held with trading intent or to hedge other elements of the trading book. Long-term strategic equity investments held until maturity are typically categorized in the banking book. These assets are not intended for short-term profit through price fluctuations and lack the active trading intent required for trading book classification.
8. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Extreme Value Theory is a specialized statistical branch focusing on the tails of probability distributions rather than the entire range. This focus allows EVT to effectively accommodate skewed and fat-tailed distributions, which often occur in financial markets during crises. By modeling the extreme ends of the distribution, it provides a more accurate assessment of potential catastrophic losses.

and policies, it acts as a critical internal control mechanism.

62. (B) P-4, Q-1, R-3, S-2

The option premium is the upfront cost paid for the right to buy or sell. A long position on a call option confers the right to buy the underlying instrument, while a long put option confers the right to sell. The strike rate is the predetermined price for these transactions. These components define the contractual rights and costs associated with using options for hedging or speculation.

63. (C) Product Transaction Memorandum

A Product Transaction Memorandum serves as a temporary operational framework for new or non-standard financial products. It allows for the limited and controlled operation of these products while a comprehensive, permanent Product Programme is being developed. This memorandum ensures that even experimental or temporary transactions are subject to defined procedures and risk oversight, preventing uncontrolled exposure during the development phase.

64. (A) Only I

Financial models used for risk monitoring must undergo periodic reviews of their underlying assumptions to ensure continued relevance and accuracy. However, unauthorized or unintended changes to these models must never be permitted, regardless of their perceived temporary benefits. Strict model governance and change control are essential to maintain the integrity of risk assessments and prevent the introduction of unverified or biased algorithms.

65. (D) Basis Point Value (BPV) — Change in value due to 10 basis points (0.10%) change in the market yield

Basis Point Value is defined as the change in the value of a financial instrument resulting from a one basis point change in the market yield. One basis point is equal to 0.01%, not 0.10%. Therefore, the description of BPV as representing a ten basis point movement is mathematically incorrect and deviates from the standard industry definition used in interest rate risk measurement.

66. (D) Eliminating the need for the Board of Directors' oversight

Stress testing is used to manage funding risk, check modeling assumptions, and determine capital charges. It provides vital information for decision-making under extreme conditions. However, it never eliminates the need for oversight by the Board of Directors. In fact, stress test results are crucial tools that the Board uses to fulfill its fiduciary duty of overseeing the institution's risk-taking and capital adequacy.

67. (D) I, II, III, IV, and V

Controlling market risk requires a comprehensive suite of tools, including limit structures, portfolio size guidelines, and performance measurement. It also necessitates robust systems for estimating risk under both normal and stressed conditions, coupled with rigorous limit monitoring and reporting. Together, these components ensure that a bank's market activities remain within boundary values, aligning operational reality with the institution's strategic risk appetite and policy.

68. (D) Frederick Macaulay

Frederick Macaulay proposed the concept of duration in 1938 as a way to measure the price sensitivity of a bond to changes in interest rates. His namesake measure, Macaulay's Duration, calculates the weighted average time until all cash flows are received. This single number revolutionized bond analysis by providing a standardized metric for comparing interest rate risk across different fixed-income securities and maturities.

69. (A) Only I, II, and III

Validation of analysis models requires approval from the Risk Policy Committee, full documentation of the financial model, and verification of the algorithm's accuracy by a designated person. These internal controls are mandatory. Furthermore, models are not exempt from external validation; regular audits by reputed external agencies are necessary to ensure independent assurance and the objective integrity of the bank's risk measurement processes.

70. (B) P-2, Q-4, R-1, S-3

The correlation method uses a deterministic approach based on variance/covariance matrices.

counterparty significantly influences the overall risk profile and potential recovery amount.

18. (C) It reduces the counterparty risk very substantially.

Using an established exchange as a central counterparty drastically reduces counterparty risk. The exchange acts as the buyer to every seller and the seller to every buyer, guaranteeing transaction performance. This institutional arrangement mitigates individual default risks through rigorous margin requirements and mutualization of losses, thereby enhancing overall market stability and providing security to all participating traders.

19. (A) The Central Counterparty Clearing Corporation

A bank's internal market risk management structure typically comprises the Board of Directors, the Asset-Liability Management Committee, and the Middle Office. These entities handle policy, oversight, and monitoring respectively. The Central Counterparty Clearing Corporation is an external market infrastructure entity. While banks interact with it, it is not a part of the bank's internal organizational hierarchy for risk management.

20. (D) If the financial instruments have negative correlation that is not perfect, the price volatility of the portfolio would still be exactly zero.

Perfect negative correlation allows for the complete elimination of price volatility in a portfolio. However, if the negative correlation is not perfect, some level of volatility will always remain. Risk mitigation strategies utilize negative correlation to reduce overall exposure, but zero volatility is only achievable when the price movements of the components exactly and reliably offset each other.

21. (B) Only I, II, IV, and V

The Asset-Liability Management Committee is responsible for product pricing, articulating the bank's interest rate view, monitoring liquidity positions, and managing the overall balance sheet. These functions aim to optimize the bank's net interest margin and liquidity. Setting specific guidelines for market risk management and reporting is typically the broader responsibility of the Risk Management Committee or the Board.

22. (B) Only I, III, and IV

In an interest rate swap where the manager receives a variable rate, rising market interest rates increase the IRS valuation. These higher receipts offset the price decline of fixed-rate bonds caused by the same rate hike. This hedging strategy effectively reduces the overall volatility of the portfolio by balancing interest rate sensitivities across different instruments within the manager's holdings.

23. (A) P-3, Q-4, R-1, S-2

The Board of Directors articulates market risk policies and limits. The Risk Management Committee ensures the robustness of risk measurement models. The Asset-Liability Management Committee focuses on protecting the bank's net interest margin. Finally, the Middle Office independently validates prices for structured products. This division of labor ensures comprehensive oversight and checks and balances within the bank's risk framework.

24. (A) Summarizing risk data to help management align risk-taking with the firm's risk appetite
Risk managers use stress test results to summarize potential extreme impacts on the portfolio. This data helps senior management ensure that the firm's risk-taking activities remain aligned with its established risk appetite. By providing a forward-looking view of disaster scenarios, stress testing complements daily VaR measures and informs strategic decisions regarding capital allocation and exposure limits.

25. (A) 2, 4, 3, 1

The market risk management process follows a logical sequence starting with risk identification. Once identified, risks are measured using various quantitative techniques. The next step involves ongoing monitoring and control to ensure exposures remain within limits. Finally, risk mitigation strategies are implemented to reduce or hedge the identified risks, completing the cycle of proactive financial risk oversight.

26. (A) 2, 4, 1, 3

Conducting a stress test begins with identifying which market parameters to stress. Subsequently, the quantum or severity of the stress must be determined. Following this, the relevant time frame for the scenario is established. The final

step involves applying these parameters to the actual portfolio to assess the resulting financial impact and potential losses for the institution.

27. (B) Only II

Sensitivity measures, such as duration or delta, do not remain constant across all values of a variable; they often change as market rates shift. Unlike comprehensive risk measures, sensitivity typically isolates the impact of a single parameter change while holding others constant. It provides a specific, localized view of risk rather than capturing the simultaneous movement of all market factors.

28. (B) P-2, Q-4, R-1, S-3

The correlation method is deterministic, using variance/covariance matrices. Historical simulation calculates changes based on actual past movements without needing such matrices. Monte Carlo simulation uses randomly generated scenarios based on user assumptions about market structures. Finally, Conditional VaR captures tail risk by averaging extreme losses beyond the threshold. These methods offer different perspectives on potential portfolio value changes.

29. (B) Corporate level clearance based on risk quantification and defined risk-return characteristics

When a trader deviates from standard procedures for a product, the resulting exposure must be addressed through formal corporate-level clearance. This process requires a thorough quantification of the added risk and an evaluation of the risk-return characteristics. Such oversight ensures that deviations are justified and that the institution's overall risk appetite is not breached by unauthorized trading activities.

30. (A) P-4, Q-3, R-2, S-1

For senior management reports, the most critical characteristic is regular and timely delivery. Reasonably accurate data is the second priority, followed by the inclusion of highlights regarding risk concentrations and exceptional events. Finally, written commentary provides necessary context. This hierarchy ensures that management receives actionable information promptly to make informed decisions about the institution's market risk profile and exposure.

31. (B) Only I, III, and IV

Basis Point Value measures the price change for a 0.01% change in yield. It fluctuates with the bond's remaining maturity and becomes zero on the day of maturity as the price converges to par. A higher BPV indicates greater price sensitivity to interest rate movements, which represents higher, not lower, risk associated with the specific bond's market value.

32. (D) It involves setting up of limits and triggers, monitoring them, and valuing the portfolio.

Risk measurement is a central pillar of the monitoring and control function. It involves establishing quantitative limits and triggers based on economic risk measures. This process also includes the continuous monitoring of these limits and the regular valuation of the portfolio. By quantifying exposure, it provides the necessary data for active management and ensures compliance with organizational risk policies.

33. (A) Only I and II

Downside potential specifically targets possible losses, purposefully ignoring any profit potential. Value at Risk quantifies how much an institution can expect to lose under normal trading conditions within a set timeframe. A 99% confidence level VaR of Rs. 10 crore actually means there is only a 1% chance that the daily loss will exceed that specific amount.

34. (B) Only I, II, III, and IV

To manage trading liquidity risk, banks should avoid holding a large market share in any single asset or investing in infrequently traded instruments. Unusual tenors and one-sided markets also hinder the ability to exit positions at fair prices. Conversely, high liquidity environments are favorable and do not need to be avoided, as they facilitate efficient trading and price discovery.

35. (B) The price would go up by 2.57%

Modified duration measures the percentage change in bond price for a one percent change in yield. Since bond prices and yields move in opposite directions, a fall in yield from 8% to 7% (a 1% decrease) results in a price increase. By multiplying the modified duration of 2.57

by the 1% yield drop, the price increases by approximately 2.57%.

36. (C) 2

In a standard normal distribution, different confidence levels correspond to specific Z-scores or standard deviation multipliers. A 95.50% confidence level specifically relates to a Z-score of 2. This means that 95.50% of the distribution's values fall within two standard deviations of the mean. Using this score allows the analyst to calculate the Value at Risk for the equity portfolio.

37. (D) Product Programme

A Product Programme is a comprehensive document that establishes the operational framework for standard banking products. It defines the necessary procedures, limits, and controls. Critically, it includes methods for market risk measurement at both the individual and aggregate portfolio levels. This ensures that every product offered by the bank operates within a strictly defined and approved risk management environment.

38. (A) Only I and II

Portfolio duration, a measure of interest rate sensitivity, can be lowered by selling instruments with high duration or adding those with low duration. These actions reduce the overall weighted average time to receive cash flows. Conversely, selling low-duration instruments would actually increase the portfolio's total duration, making it more sensitive to yield changes rather than less, which contradicts the goal.

39. (C) Both I and II

Volatility for VaR is often estimated using historical data through arithmetical moving averages. The exponential moving average method is another common approach, where volatility estimates react quickly to market shocks but decay more slowly over time. Both methods provide different ways to quantify the expected price fluctuations of assets based on their observed historical behavior in the financial markets.

40. (A) Scenario Analysis

Scenario analysis involves constructing hypothetical or historical events to evaluate a

portfolio's performance under extreme conditions. By mimicking a previous market crash, the risk group assesses how current holdings would react to similar liquidity constraints. This forward-looking technique helps management understand potential vulnerabilities that standard daily risk measures might overlook, especially regarding correlations and liquidity during periods of severe market stress.

41. (C) 2.326

For risk calculations based on a standard normal distribution, the 99% confidence level corresponds to a Z-score of approximately 2.326. This multiplier is used to determine the threshold below which only one percent of potential outcomes lie. It is a standard parameter in the calculation of Value at Risk, representing the worst-case loss that is not expected to be exceeded.

42. (B) The risk of mark-to-market losses on the trading portfolio due to price fluctuations during liquidation

Market risk specifically refers to the potential for financial loss resulting from adverse movements in market prices. For a trading portfolio, this risk manifests as mark-to-market losses caused by fluctuations in interest rates, equity prices, or exchange rates during the period required to liquidate positions. It captures the sensitivity of the portfolio's value to the volatility of external market factors.

43. (C) Profit of Rs. 1,600

The Basis Point Value for the trader's Rs. 10 lakh face value position is Rs. 200 (calculated as Rs. 2,000 divided by ten). Since bond prices rise when yields fall, an 8 basis point decline in yield results in a profit. Multiplying the BPV of Rs. 200 by the 8 basis point movement yields a total profit of Rs. 1,600.

44. (C) Risk of technical breakdowns within the exchange's trading platform

Investors in traded securities primarily face risks related to price movements and market liquidity. Technical breakdowns within an exchange's platform are classified as operational risks of the exchange rather than direct market or liquidity risks of the security itself. While such failures impact trading ability, they are distinct from the

Oct/Nov 2012

75. An investor has Rs. 600,000 in Stock 'A'. The market factor sensitivity (for a 1% change) is Rs. 6,000. The daily volatility is 3%, and the defeasance period is 1 day. If the standard deviation (z-score) at a 99% confidence level is 2.326, what is the Value at Risk (VaR) reflecting the daily potential loss?
- (A) Rs. 6,000
(B) Rs. 18,000
(C) Rs. 41,868
(D) Rs. 600,000

May/June 2011

76. What is the most appropriate reason why modern best practices emphasize setting risk limits based on economic measures of risk?
- (A) To strictly eliminate all downside variability in net cash flows regardless of the opportunity cost
(B) To rely completely on historical simulation without requiring any explicit assumptions about market structures
(C) To ensure the best risk-adjusted return keeping in view the capital that has been invested in the business
(D) To bypass the requirement for stress testing and back testing models

Oct/Nov 2020

77. Which of the following statements incorrectly characterizes market risk mitigation?
- (A) Market risk arises due to volatility of financial instruments.
(B) Risk mitigation reduces downside variability while leaving the upside profit potential completely unaffected.
(C) Risk mitigation strategies aim to eliminate or reduce the volatility of the portfolio.
(D) Risk mitigation strategies that involve a counterparty will always be associated with counterparty risk.

May/June 2022

78. In assessing market risk, which volatility parameter is described as largely unaffected by time and duration but rises as yields fall?
- (A) Price Volatility
(B) Yield Volatility
(C) Market Liquidity Volatility
(D) Defeasance Volatility

May/June 2016

79. A trader takes a long position on Stock X and expects it to move up. To mitigate downside market risk, the trader shorts the stock future of Stock X. If the price of Stock X moves up by Rs. 10, and the stock future goes up by Rs. 9, what is the net effect on the portfolio's value?
- (A) The portfolio will gain Rs. 10 and lose nothing.
(B) The portfolio will lose Rs. 9 overall.
(C) The portfolio volatility remains perfectly unchanged.
(D) A net gain of Rs. 1, calculated as a Rs. 10 gain on the stock minus a Rs. 9 loss on the future.

May/June 2023

80. Which of the following pairs concerning the interaction of volatility correctly reflects the formula established for price volatility?
- (A) Price Volatility — (Yield volatility x Modified Duration) / Price
(B) Yield Volatility — (Price volatility x BPV) / Yield
(C) Yield Volatility — (Price x BPV x Yield volatility) / Duration
(D) Price Volatility — (Yield volatility x BPV x Yield) / Price

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- 53.** (D) Historical simulation — Relies heavily on a variance/covariance matrix to predict future historical movements

Historical simulation is a non-parametric approach that uses actual past price movements to estimate potential future changes. Crucially, it does not rely on a variance/covariance matrix or assumptions about the normal distribution of returns. Instead, it assumes that the distribution of past returns is a reliable indicator of future risk, making it distinct from the matrix-dependent correlation method.

- 54.** (C) The higher the risk level, the lower the spread over the risk-free rate.

In financial markets, higher risk is always compensated by higher returns. Therefore, as the credit risk level of an issuer increases, the spread over the risk-free rate must also increase. A lower spread for higher risk would be illogical and contradict fundamental pricing principles. Investors demand a larger premium to hold riskier assets, which is reflected in wider spreads and lower prices.

- 55.** (B) Long position on a Put Option

A long position on a put option gives the holder the right, but not the obligation, to sell an underlying asset at a predetermined strike price. By paying an upfront premium, the manager secures protection against a decline in the portfolio's value below that strike price. This strategy effectively limits downside risk while allowing the manager to retain the underlying stocks and potential upside.

- 56.** (D) I, II, III, IV, and V

A comprehensive stress test must be relevant to current positions and consider changes in all market rates. It should examine potential regime shifts, account for market illiquidity, and analyze the interplay between different risk types, especially market and credit risk. By incorporating these diverse elements, a stress test provides a robust and realistic assessment of an institution's vulnerability to extreme market events.

- 57.** (D) Assertion (A) is false, but Reason (R) is true. Market liquidity risk and funding liquidity risk are distinct concepts. Market liquidity risk relates to the ease of trading assets at fair prices, whereas

funding liquidity risk concerns a bank's ability to meet its financial obligations as they fall due. While they can influence each other during crises, they are not identical. The assertion is false because it equates two different functional aspects of liquidity.

- 58.** (D) Assertion (A) is false, but Reason (R) is true. Risk mitigation in over-the-counter deals does not eliminate counterparty risk; rather, it introduces or maintains exposure to the specific party involved in the contract. Unlike exchange-traded instruments where a central clearinghouse guarantees performance, OTC deals rely on the creditworthiness of the individual counterparty. Therefore, while mitigation strategies manage market exposure, they remain inherently linked to the risk of counterparty default.

- 59.** (B) Risk Identification, Risk Measurement, Risk Monitoring and Control, Risk Mitigation

The standard process for managing market risk is divided into four key stages. First, risks are identified within the portfolio. Next, they are quantified through measurement techniques. Third, continuous monitoring and control mechanisms ensure adherence to limits. Finally, risk mitigation strategies are employed to reduce exposure. This systematic approach ensures a comprehensive and disciplined framework for overseeing the institution's market-related vulnerabilities.

- 60.** (A) Add another Bond B to the portfolio

The portfolio's current average BPV is 440. To reduce this average to 361.7, the bank must increase the proportion of the instrument with the lower BPV. Since Bond B has a BPV of 205, which is significantly lower than the current average and Bond A's BPV of 675, adding more of Bond B will successfully pull the weighted average BPV down.

- 61.** (C) Independent monitoring and reporting of the treasury's market risk profile

The Middle Office serves as an independent unit within a bank's risk organization, separate from the front-office treasury and the back-office operations. Its primary function is to monitor and report on the market risk profile of the treasury's activities. By providing unbiased oversight and ensuring compliance with established risk limits

inherent financial risks associated with holding and valuing the underlying security.

- 45. (B) Continuous comparison of model-based VaR against actual portfolio performance.**

Back testing is a critical validation process in risk management. It involves the systematic and continuous comparison of the losses predicted by Value at Risk models against the actual realized performance of the portfolio. This comparison identifies if the model is underestimating or overestimating risk, ensuring that the quantitative assumptions remain valid and that the institution maintains adequate capital for its exposures.

- 46. (C) Market losses caused by lack of care in monitoring rather than price movements are operational risks.**

While market risk arises from external price fluctuations, operational risk stems from internal failures. If market losses occur because of a deficiency in monitoring the portfolio rather than purely due to adverse price movements, they are categorized as operational risks. Clear distinction between these risk types is essential for appropriate risk allocation, capital charging, and the implementation of effective internal controls.

- 47. (D) Simple Sensitivity Test**

A simple sensitivity test isolates the impact of a specific market factor, such as exchange rates, by applying predefined shocks while holding all other variables constant. This approach allows risk managers to understand the portfolio's vulnerability to specific movements in isolation. Unlike scenario analysis, which considers multiple factors simultaneously, sensitivity testing provides a focused view of how one parameter drives potential value changes.

- 48. (C) Both I and II**

Asset liquidation risk occurs when a specific instrument faces trading difficulties despite normal market conditions elsewhere. In contrast, market liquidation risk represents a systemic event where a general liquidity crunch affects all asset classes simultaneously. Both forms of risk highlight the challenges of exiting positions at fair market prices, which is a critical consideration for managing trading desk exposures and stability.

- 49. (B) Maximum Loss**

The maximum loss technique identifies the worst possible combination of market factor movements to assess potential portfolio damage. Because the choice of scenarios can be arbitrary and extreme, risk managers often find it difficult to use this method for setting systematic exposure limits. However, it remains a valuable tool for understanding the ultimate boundaries of risk under highly improbable but catastrophic conditions.

- 50. (C) The ability to transact in markets at fair prices without significantly impacting price or market attention**

Trading liquidity refers to the ease with which an asset can be bought or sold in the market. A liquid market allows for transactions at fair prices with minimal price impact and without attracting undue attention. This capability is essential for managing portfolio risks efficiently, as it ensures that positions can be entered or exited promptly in response to changing market conditions.

- 51. (A) Only I, II, and III**

Controlling market risk involves establishing boundary values through unbundling transactions, setting policy guidelines for authority, and defining clear mark-to-market policies. These measures provide a structured environment for risk-taking. Ignoring portfolio size and mix guidelines to maximize returns would violate these control principles, as it removes the necessary limits that prevent excessive risk accumulation and ensure institutional stability.

- 52. (D) Commodities**

Currently, banks are permitted to hold proprietary positions in foreign exchange, equities, and various derivatives within their trading books. However, proprietary trading in commodities is generally not allowed for banks. This restriction is intended to limit exposure to highly volatile and specialized commodity markets, ensuring that bank capital is primarily deployed in financial instruments more aligned with traditional banking and financial intermediation roles.

Historical simulation relies on actual past price movements without such matrices. Monte Carlo simulation generates random price scenarios based on user-defined market structures. Finally, Conditional VaR, or expected shortfall, averages extreme losses that fall beyond the standard VaR threshold. Each approach offers unique advantages in quantifying potential portfolio losses under different market assumptions.

71. (D) I, II, III, IV, and V

Effective reports for senior management must be reasonably accurate, concise, and delivered in a timely manner. They should include highlights of risk concentrations and exceptional events to draw attention to critical issues. Written commentary is also essential to provide context and explain the implications of the data. Together, these characteristics ensure that the CEO and other executives can make informed, rapid strategic decisions.

72. (A) VaR provides a predicted worst-case scenario regardless of confidence levels.

Value at Risk does not provide a single worst-case scenario regardless of confidence levels. Instead, it predicts potential loss specifically within a defined confidence interval under normal market conditions. It explicitly ignores extreme outcomes in the tail of the distribution that fall beyond its chosen confidence level. Therefore, it is not an absolute measure of the maximum possible loss the institution could face.

73. (A) Validation by a reputed external agency

While internal validation by a designated person is an essential first step, the market risk management framework mandates further oversight. Financial models used for revaluation and risk monitoring must be validated by a reputed external agency at least once a year. This external verification provides independent assurance that the models remain robust, accurate, and aligned with industry best practices and regulatory expectations.

74. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Longer duration in a security directly corresponds to greater price sensitivity when yields change. This is because modified duration quantifies the

approximate percentage change in price for a unit change in yield. Consequently, the estimated price change is calculated by multiplying the modified duration by the observed or anticipated yield change. This relationship explains why duration is the primary metric for assessing interest rate risk.

75. (C) Rs. 41,868

Value at Risk is calculated by multiplying the position value by the volatility and the Z-score for the desired confidence level. For this investment, multiplying Rs. 600,000 by 3% daily volatility and the 99% confidence Z-score of 2.326 results in a VaR of Rs. 41,868. This figure represents the potential daily loss that is expected to be exceeded only 1% of the time.

76. (C) To ensure the best risk-adjusted return keeping in view the capital that has been invested in the business

Modern risk management emphasizes economic measures of risk to align institutional risk-taking with capital efficiency. By setting limits based on these measures, banks can optimize their risk-adjusted returns. This approach ensures that the capital invested in various business lines is used effectively, providing a balanced perspective that considers both the potential for profit and the associated economic cost of the risks taken.

77. (B) Risk mitigation reduces downside variability while leaving the upside profit potential completely unaffected.

Risk mitigation typically involves a trade-off where reducing downside variability also limits the potential for upside gains. For instance, hedging with futures or swaps stabilizes cash flows in both directions. It is incorrect to claim that mitigation leaves profit potential unaffected. Most strategies that provide protection against losses simultaneously sacrifice some degree of the opportunity to benefit from favorable market movements.

78. (B) Yield Volatility

Yield volatility measures the fluctuations in market yields and is largely unaffected by the time or duration of the underlying instrument. However, it exhibits a characteristic relationship where volatility tends to rise as yields fall. This is distinct from price volatility, which is directly

- (B) 3 or 4 officers
- (C) 4 or 5 officers
- (D) 5 or 6 officers

May/June 2021

8. Consider the following statements. Which of the following elements are necessary components of a successful transaction documentation process in credit derivatives?
- I. Presentation by the credit derivatives trading team to documentation of a transaction term sheet setting out terms unambiguously.
 - II. A problem-solving approach with the credit derivatives trading desk, end-users, and other internal partners.
 - III. Ensuring all settlement methods are physically constrained to cash settlements only.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2010

9. In the computation of exposure in a collateralised transaction, what does the component 'He' represent in the risk mitigation formula?
- (A) Haircut appropriate to the exposure
 - (B) Haircut appropriate to the collateral
 - (C) Haircut appropriate for currency mismatch
 - (D) Current value of the collateral received

May/June 2005

10. Consider the following statements. Regarding Credit Linked Notes (CLN), which of the following are correct?
- I. CLNs allow the risk to be distributed to a much broader market of investors compared to credit default swaps.
 - II. The credit risk delivered to a CLN investor is a dual risk involving the issuer and the reference obligation.
 - III. CLNs are generally off-balance sheet items and are considered unfunded exposures.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2022

11. How does 'Systematic or Intrinsic Risk' differ from 'Concentration Risk' within a credit portfolio?
- (A) Systematic risk is inherent to the whole market, while concentration risk arises from a lack of diversification.
 - (B) Systematic risk arises from having higher weight in respect of a specific industry or a single large borrower.
 - (C) Systematic risk can be completely eliminated by diversification, whereas concentration risk is unmitigable.
 - (D) Systematic risk only impacts corporate exposures, while concentration risk only applies to retail lending.

May/June 2018

12. Consider the following statements. Which of the following are recognized as measures to maintain portfolio quality?
- I. Quantitative ceiling on aggregate exposure in specified rating categories.
 - II. Industry-wise and sector-wise monitoring of exposure performance.
 - III. Introducing discriminatory time schedules for review of borrowers.
 - IV. Targeting expected defaults and provisioning requirements as a prudent planning exercise.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, III, and IV only
 - (C) II, III, and IV only
 - (D) I, II, III, and IV

Oct/Nov 2016

13. What is the fundamental difference between a Traditional Securitisation and a Synthetic Securitisation?
- (A) Traditional securitisation is for residential mortgages, while synthetic is exclusively for commercial loans.
 - (B) Traditional uses pool cash flows to service risk positions, while synthetic transfers risk via derivatives.
 - (C) Traditional retains assets on the balance sheet, while synthetic physically transfers ownership to an SPV.
 - (D) Traditional involves only one risk position, while synthetic involves at least two stratified positions.

CHAPTER 15

Credit Risk

Oct/Nov 2018

1. Based on the scenario provided, what is the net exposure value after risk mitigation (E^*) for the bank?
- (A) Rs. 0 crores
 - (B) Rs. 7 crores
 - (C) Rs. 32 crores
 - (D) Rs. 432 crores

May/June 2007

2. Which of the following pairs identifying the type of risk and its categorization is INCORRECTLY matched?
- (A) Default Risk — Transaction level risk
 - (B) Systematic Risk — Portfolio risk component
 - (C) Concentration Risk — Counterparty risk variant
 - (D) Downgrade Risk — Transaction level risk

Oct/Nov 2025

3. How is 'Credit Spread Risk' or 'Downgrade Risk' defined in the context of risk identification?
- (A) Risk of credit quality deterioration for a non-defaulting borrower, usually seen through a rating downgrade.
 - (B) Risk driven by the potential failure of a borrower to make promised payments of principal or interest.
 - (C) Risk of loss arising from the non-performance of trading partners in complex derivative or swap contracts.
 - (D) Risk that a lending portfolio will underperform due to heavy geographical or sectoral concentration.

May/June 2012

4. Consider the following statements regarding defined Credit Events in derivative contracts:
- I. Standardised Credit Events include six events, namely bankruptcy, obligation acceleration, obligation default, failure to pay, repudiation/moratorium, and restructuring.
 - II. Credit Derivatives are generally exchange-traded instruments, which is why standard

documentation is used.

Which of the above statement(s) is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II is correct
- (D) Neither I nor II is correct

Oct/Nov 2014

5. How is a 'Credit Derivative' defined?
- (A) An on-balance sheet instrument that physically transfers the underlying asset from the originator to the investor.
 - (B) A securitised pool of commercial loans specifically designed to remove illiquid assets from the balance sheet.
 - (C) A statutory requirement mandating banks to retain a specific portion of their securitized loan portfolio for risk.
 - (D) An OTC bilateral contract transferring credit asset risks without necessarily transferring the underlying asset.

May/June 2019

6. Consider the following statements regarding the eligibility of reference obligations for Credit Default Swaps (CDS):
- I. CDS will be allowed only on money market debt instruments and rated corporate bonds as reference obligations, and bonds with call/put options are strictly ineligible.
 - II. Asset-backed securities, mortgage-backed securities, and convertible bonds shall not be permitted as reference obligations.

Which of the above statement(s) is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II is correct
- (D) Neither I nor II is correct

Oct/Nov 2006

7. Under the credit approving authority guidelines, an 'Approval Grid' or a 'Committee' should comprise at least how many officers?
- (A) 2 or 3 officers

- (A) 3% of the book value of the loans being securitised
- (B) 5% of the book value of the loans being securitised
- (C) 7.5% of the book value of the loans being securitised
- (D) 10% of the book value of the loans being securitised

Oct/Nov 2014

47. Consider the following statements. The motivation for active credit portfolio management arises from changing demand of traditional products due to which of the following reasons?

- I. Less demand due to disintermediation.
- II. More supply due to capital mobility.
- III. Lower returns and increased importance of risk.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2019

48. In Altman's Z-Score model for manufacturing firms, what does the variable 'X2' represent?

- (A) Net Working capital/Total assets ratio
- (B) Earnings before interest and taxes/Total assets ratio
- (C) Sales/Total assets
- (D) Retained earnings/Total assets ratio

Oct/Nov 2006

49. Consider the following statements. Which of the following accurately reflect rules regarding Credit Rating Standards and Benchmarks?

- I. The updating of credit ratings should normally be undertaken at quarterly intervals or at least at half-yearly intervals.
- II. The credit risk assessment exercise should be repeated bi-annually and should be strongly linked to the regular renewal exercise.
- III. The responsibility for setting or confirming internal ratings should vest with the Loan Review function examined by an independent Loan Review Group.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only

- (C) II and III only
- (D) I, II, and III

May/June 2021

50. The concept of 'Risk-Reward parity' in loan pricing implies that:

- (A) All borrower accounts should be priced uniformly to maintain market share regardless of credit rating.
- (B) Loans should be priced based strictly on the value of collateral offered, ignoring default probability.
- (C) Lower-rated accounts should be priced higher than higher-rated ones to cover the increased cost of default.
- (D) Banks should reduce prices for market share even if it results in the underpricing of associated risks.

Oct/Nov 2010

51. Consider the following statements. Identify the correct statements regarding the measurement of portfolio risk and diversification:

- I. Diversification occurs both at the borrower level and at the geographical level besides across trades and industries.
- II. The corresponding capital that must be held against defaults for a well-diversified portfolio is only a fraction of the total exposure.
- III. Portfolio risk is eliminated entirely when diversified across geographies and industries.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2005

52. The 'CreditMetrics' model evaluates credit risks by focusing on:

- (A) The actuarial calculation of expected default rates and the unexpected losses resulting from a default event.
- (B) Combining five financial ratios using reported accounting information to forecast specific bankruptcy probability.
- (C) Computing the Conditional Value at Risk directly using standardized regulatory risk-weighting functions.
- (D) Estimating asset value volatility by tracking

May/June 2014

14. Consider the following statements. Which of the following are typical motives for Protection Sellers to enter into credit derivatives?
- Yield Enhancement.
 - Speculation.
 - Diversification of credit risk.
 - Hedging against credit risks to reduce capital requirement.
- Which of the above statement(s) is/are correct?
- I, II, and III only
 - I, II, and IV only
 - II, III, and IV only
 - I, III, and IV only

Oct/Nov 2007

15. Which of the following is a correct statement regarding Credit Default Swaps (CDS)?
- A CDS transaction requires the physical transfer of the underlying credit asset at the inception of the contract.
 - The protection buyer receives a periodic premium from the protection seller for assuming the credit risk.
 - CDS protects against market risks like interest rate fluctuations rather than the credit risk of the principal.
 - CDS involves the buyer paying a premium for protection against a credit event on a reference obligation.

May/June 2025

16. Consider the following statements. Which of the following tools or activities represent the migration to Active Credit Portfolio Management?
- Secondary loan trading
 - Securitisation
 - Credit derivatives
 - Human resource training and careful system selection
- Which of the above statement(s) is/are correct?
- I, II, and III only
 - I, II, and IV only
 - II, III, and IV only
 - I, II, III, and IV

Oct/Nov 2019

17. Which statement accurately reflects the provisions regarding physical settlement in a credit derivative transaction?
- The protection seller pays the difference

between the par and market value of the defaulted reference obligation.

- The buyer delivers the reference obligation to the seller in exchange for the notional amount of the swap.
- The calculation agent determines the post-default cash value of the reference obligation to calculate settlement.
- The protection buyer receives only the accrued interest of the reference asset without any transfer of the asset.

May/June 2009

18. Consider the following statements. Acceptability of a rating model by regulatory authorities is tested based on whether relevant risk drivers have been taken into account. These factors cover which of the following areas?
- Management
 - Financials
 - Past conduct
 - Business-related issues
 - Industry
- Which of the above statement(s) is/are correct?
- I, II, III, and V only
 - I, II, IV, and V only
 - I, III, IV, and V only
 - I, II, III, IV, and V

Oct/Nov 2011

19. Which of the following statements regarding the Loan Review Mechanism (LRM) is INCORRECT?
- Loan Review Officers report to the Credit Administration Department instead of the Board of Directors.
 - LRM evaluates the effectiveness of loan administration and maintains the integrity of the credit grading process.
 - LRM aims to provide information for determining the adequacy of loan loss provision.
 - Reviews of high-value loans should be undertaken usually within three months of sanction/renewal.

May/June 2010

20. Consider the following statements. The framework of credit control and monitoring at the portfolio level includes which of the following activities?
- Identification of portfolio credit weakness in

advance through credit quality migrations.

- II. Moving from measuring concentration effects to obligor specific risk.
- III. Evaluating exposure distribution over rating categories and stipulating quantitative ceilings.
- IV. Evaluating rating-wise distribution in various industries and setting exposure limits.
- V. Moving towards Credit Portfolio Value at Risk Models.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, IV, and V only

Oct/Nov 2024

21. Which of the following statements about Credit Spread Options is INCORRECT?
- (A) They enable credit hedgers to acquire protection from an unfavourable migration or widening of an asset's credit spread.
 - (B) They transfer credit spread risk from the protection buyer to an investor in return for an upfront or periodic premium.
 - (C) They may be exercised for a specified period at a pre-set strike quoted in cash price or benchmark spread terms.
 - (D) They can only be exercised in European style and must be physically settled.

May/June 2017

22. The following question consists of two statements — an Assertion (A) and a Reason (R).
- Assertion (A): Loans falling under the banking book category are exempted from the mark-to-market (MTM) process.
- Reason (R): The only important factor for loans in the banking book is whether or not the loan is in default today, as this is the only credit event that can lead to an immediate loss.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

23. A credit rating process normally consists of multiple parameters. Which of the following is NOT a standard parameter in the credit rating process?
- (A) Financial Parameter
 - (B) Geopolitical Parameter
 - (C) Management Parameter
 - (D) Industry Parameter

May/June 2020

24. The following question consists of two statements — an Assertion (A) and a Reason (R).
- Assertion (A): While the use of Credit Risk Mitigation (CRM) techniques reduces or transfers credit risk, it simultaneously may increase other risks such as legal, operational, liquidity, and market risks.
- Reason (R): Banks should employ robust procedures and processes to control these collateral risks that arise during the risk mitigation process.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2015

25. For the purpose of offering credit derivative contracts, users are classified as non-retail users. Which of the following is NOT eligible to be classified as a non-retail user?
- (A) Resident companies with a minimum audited net worth of exactly Rs. 100 crore.
 - (B) Mutual Funds regulated by the relevant securities authority.
 - (C) Insurance Companies regulated by the relevant insurance authority.
 - (D) Pension Funds regulated by the relevant pension authority.

May/June 2013

26. The following question consists of two statements — an Assertion (A) and a Reason (R).
- Assertion (A): In a Total Return Swap (TRS), the protection buyer is protected against both credit

risk and market risk, but the principal is not covered.

Reason (R): TRS provides for the payment of the total actual return, capturing the economic return of the asset, which by definition protects only the returns on the principal.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2021

27. What is the primary objective of creating an organisation structure for credit risk management?
- (A) To align risk and business policies for consistent implementation across the bank.
 - (B) To eliminate all default risk and credit spread risk at the individual transaction level.
 - (C) To act as a substitute for external rating agencies in standardizing the bank's loan pricing.
 - (D) To ensure that all loan portfolios are marked-to-market on a daily basis for external reporting.

May/June 2024

28. Based on the scenario provided, what is the default probability of the 'A' rated borrowers based solely on this one-year rating migration data?
- (A) 0.5%
 - (B) 1.0%
 - (C) 1.5%
 - (D) 2.0%

Oct/Nov 2008

29. In the context of credit control and monitoring at the portfolio level, why is tracking non-performing loans around the balance sheet date considered insufficient?
- (A) Because non-performing loans are only relevant for retail lending, not for corporate exposures.
 - (B) Because it fails to signal overall loan book quality or identify weaknesses well in advance.

- (C) Because non-performing loans are marked-to-market daily, creating extreme volatility in reporting.
- (D) Because non-performing loans only capture downgrade risk rather than actual default risk events.

May/June 2006

30. Under standard Minimum Retention Requirement (MRR) guidelines, what is the MRR amount that the bank must retain for the loans with an original maturity of 18 months?
- (A) Rs. 15 Crores
 - (B) Rs. 25 Crores
 - (C) Rs. 37.5 Crores
 - (D) Rs. 50 Crores

Oct/Nov 2017

31. According to the guidelines on Loan Review Mechanism (LRM), what is the recommended minimum proportion of the portfolio that should be subjected to LRM in a year?
- (A) 10–20%
 - (B) 20–30%
 - (C) 30–40%
 - (D) 50–60%

May/June 2008

32. In a Collateralised Loan Obligation (CLO) structure, if high levels of default occur in the underlying pool described in the scenario, which tranche is most likely to withstand the defaults without interrupting contractual payments?
- (A) Subordinated Tranche
 - (B) Mezzanine Tranche
 - (C) Equity Tranche
 - (D) Senior Tranche

Oct/Nov 2013

33. Consider the sequence of actions in the event of a physical settlement of a Credit Default Swap (CDS). What is the chronological sequence of actions between the Protection Buyer (PB) and the Protection Seller (PS)?
- I. A specified credit event occurs and a credit event notice is generated.
 - II. The PB pays a periodic premium under an initial agreement.
 - III. The PS pays the par value plus accrued interest of the reference asset to the PB.
 - IV. The PB delivers (hands over or assigns) the reference asset to the PS.

influenced by the bond's duration and maturity, making yield volatility a purer measure of the underlying market's interest rate uncertainty.

- 79.** (D) A net gain of Rs. 1, calculated as a Rs. 10 gain on the stock minus a Rs. 9 loss on the future.

In a hedged position where an investor is long on a stock and short on its future, price movements offset each other. A Rs. 10 increase in the stock price results in a Rs. 10 gain, while the Rs. 9 increase in the stock future results in a Rs. 9 loss for the short position. The net result is a gain of Rs. 1, demonstrating partial risk mitigation.

- 80.** (D) Price Volatility — $(\text{Yield volatility} \times \text{BPV} \times \text{Yield}) / \text{Price}$

Price volatility is derived from the interaction of yield volatility and the sensitivity of the instrument's price to yield changes. The established formula calculates price volatility as the product of yield volatility, the Basis Point Value, and the current yield, divided by the price. This relationship allows risk managers to translate anticipated fluctuations in market yields into the expected volatility of the portfolio's mark-to-market value.

- (B) Residential mortgage-backed securities — MRR shall be 5% of the book value regardless of original maturity.
- (C) Loans with original maturity of more than 24 months — MRR shall be set at 5% of the book value of the loan.
- (D) Specific loans with bullet repayments — MRR shall be set at 5% of the book value of the loan portfolio.

May/June 2016

40. Based on the scenario provided, what is the value representing the collateral adjusted for the haircut?
- (A) Rs. 400 crores
 - (B) Rs. 425 crores
 - (C) Rs. 485 crores
 - (D) Rs. 500 crores

Oct/Nov 2009

41. Which of the following pairs relating to the objectives of the Loan Review Mechanism (LRM) is INCORRECTLY matched?
- (A) Top management information — To provide top management with information on marketing strategies and recruitment.
 - (B) Identification of problem areas — To evaluate portfolio quality and isolate potential problem areas.
 - (C) Adequacy of provision — To provide information for determining adequacy of loan loss provision.
 - (D) Corrective action — To identify credit weaknesses and initiate timely corrective action for loans.

May/June 2023

42. According to the concept of credit risk, how does it primarily arise in the context of a bank's lending activities?
- (A) It arises when a bank fails to manage its internal operational and administrative processes efficiently.
 - (B) It occurs when a borrower defaults on interest or principal installment payments when due.
 - (C) It arises due to sudden and significant fluctuations in foreign exchange rates in global markets.
 - (D) It arises when there is a significant mismatch between the maturities of the bank's assets and liabilities.

Oct/Nov 2018

43. Consider the following statements regarding the measurement of expected and unexpected loan losses:
- I. Expected loan losses represent the amount of loan losses that a bank would experience over a chosen time horizon.
 - II. Unexpected loan losses represent the amount by which actual losses fall short of the expected losses.
- Which of the above statement(s) is/are correct?
- (A) Only I is correct
 - (B) Only II is correct
 - (C) Both I and II is correct
 - (D) Neither I nor II is correct

May/June 2007

44. What is the definition of 'Securitisation'?
- (A) The process of providing a guarantee for a third party's exposure to mitigate specific transaction level risks.
 - (B) The contractual arrangement in which a bank assumes a specific credit exposure from a financial lease agreement.
 - (C) The conversion of illiquid long-term loans into tradable short-term bonds via a Special Purpose Vehicle.
 - (D) The over-the-counter bilateral contract that provides for the transfer of risks in a specific credit asset.

Oct/Nov 2025

45. Consider the following statements regarding the review of small value retail loan accounts:
- I. Such assets are usually subjected to review on an exception basis.
 - II. Segments showing above average default performance are exclusively taken up for review and putting in place remedial actions.
- Which of the above statement(s) is/are correct?
- (A) Only I is correct
 - (B) Only II is correct
 - (C) Both I and II is correct
 - (D) Neither I nor II is correct

May/June 2012

46. What is the minimum retention requirement (MRR) for underlying loans with an original maturity of more than 24 months, while securitising loans leading to the issuance of securitisation notes?

- (A) II, I, IV, III
- (B) II, IV, I, III
- (C) I, II, III, IV
- (D) I, IV, II, III

May/June 2015

34. How does the TRS strategy described in the scenario directly benefit the bank in terms of portfolio management?
- (A) It allows the bank to increase its market share by underpricing the risk of the steel sector.
 - (B) It permanently removes the loan from the balance sheet, avoiding all counterparty risk.
 - (C) It retains the customer, hedges risk, and reduces the required regulatory capital.
 - (D) It forces the hedge fund to assume all operational and legal liabilities of the original borrower.

Oct/Nov 2012

35. Match the specific types of risks in List I with their descriptions in List II.

List I: (Risk Types)

- P. Default Risk
- Q. Downgrade Risk
- R. Systematic Risk
- S. Concentration Risk

List II: (Descriptions)

1. Risk reflecting the impact of economic, geopolitical, and financial factors inherent to the market as a whole.
 2. Risk arising when a portfolio has higher weight in respect of a borrower, geography, or industry.
 3. Risk driven by the potential failure of a borrower to make promised payments partly or wholly.
 4. Risk resulting from worsening in credit quality and possible widening of the credit-spread, without actual failure to pay.
- (A) P-3, Q-4, R-1, S-2
 - (B) P-4, Q-3, R-2, S-1
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-1, Q-2, R-3, S-4

May/June 2011

36. Based on Altman's Z-Score formula ($Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$), what is the calculated Z-score for the firm?
- (A) 1.730

- (B) 1.810
- (C) 1.915
- (D) 2.120

Oct/Nov 2020

37. Match the terminology related to Securitisation in List I with its description in List II.

List I: (Securitisation Terminology)

- P. Clean-up call
- Q. Credit enhancement
- R. Asset-backed commercial paper (ABCP)
- S. Minimum Retention Requirement (MRR)

List II: (Descriptions)

1. An option that permits securitisation exposures to be called before all underlying exposures have been repaid.
 2. Designed to ensure originators have a continuing stake in the performance of securitised assets.
 3. A programme that predominately issues short-term paper backed by assets held in a bankruptcy-remote entity.
 4. A contractual arrangement where the bank provides some degree of added protection to other parties.
- (A) P-1, Q-4, R-3, S-2
 - (B) P-4, Q-1, R-2, S-3
 - (C) P-1, Q-3, R-4, S-2
 - (D) P-2, Q-4, R-1, S-3

May/June 2022

38. Based on the calculated Z-score from the scenario, how should the firm be classified?

- (A) Classified as a high-risk borrower because the calculated Z-score is lower than the 1.81 threshold.
- (B) Classified as a high-risk borrower because the calculated Z-score is higher than the 1.81 threshold.
- (C) Classified as not a high-risk borrower due to a Z-score above 1.81, indicating lower risk.
- (D) Classified as a non-performing asset because the X5 variable is calculated to be below 1.0.

Oct/Nov 2023

39. Which of the following pairs correctly matches the MRR (Minimum Retention Requirement) with the loan category under standard regulatory guidelines?

- (A) Loans with original maturity of 24 months or less — MRR shall be set at 10% of the book value of the loan.

rating migrations and variations in the underlying credit quality.

Oct/Nov 2022

53. Consider the following statements. The depth of Loan Reviews under the LRM should focus on which of the following areas?
- I. Adherence to internal policies and procedures.
 - II. Sufficiency of loan documentation.
 - III. Marketing strategies for retail loan products.
 - IV. Accuracy and timeliness of credit ratings assigned by loan officers.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, II, and IV only
 - (C) II, III, and IV only
 - (D) I, III, and IV only

May/June 2018

54. Which of the following statements correctly describes the role of the Credit Policy Committee (CPC)?
- (A) It enforces and monitors the compliance of risk parameters set by the Risk Management Department.
 - (B) It articulates aggregate risk limits and decides the level of credit risk for the bank's profit goals.
 - (C) It sets credit policy standards, financial covenants, and procedures for presenting credit proposals.
 - (D) It conducts portfolio evaluations and independent studies to test the resilience of the loan portfolio.

Oct/Nov 2016

55. Consider the following statements. Which of the following external and internal factors affect the credit risk of a bank's portfolio?
- I. Wide swings in commodity/equity prices and foreign exchange rates.
 - II. Absence of prudential credit concentration limits.
 - III. Excessive dependence on collaterals and inadequate risk-pricing.
 - IV. Implementation of robust credit derivative documentation frameworks.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, III, and IV only
 - (C) II, III, and IV only

(D) I, II, III, and IV

May/June 2014

56. Which of the following correctly describes Total Return Swaps (TRS)?
- (A) A TRS swaps an asset's total return for a premium, transferring credit and market risks without physical lending.
 - (B) In a TRS, the protection seller captures only the credit risk of the reference asset, identical to a credit default swap.
 - (C) TRS reference obligations are restricted strictly to unrated corporate bonds and exclude any index or equity shares.
 - (D) A TRS covers the credit and market risk and additionally provides principal protection upon the maturity of the asset.

Oct/Nov 2007

57. Consider the following statements. The instruments of Credit Risk Management at the transaction level include which of the following?
- I. Credit Appraisal Process
 - II. Risk Analysis Process
 - III. Credit Audit and Loan Review Mechanism
 - IV. Monitoring Process
 - V. Credit Portfolio Value at Risk Models
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV only
 - (B) I, II, IV, and V only
 - (C) II, III, IV, and V only
 - (D) I, III, IV, and V only

May/June 2025

58. Identify the INCORRECT statement regarding the Board of Directors' responsibility in credit risk management.
- (A) The Board decides the level of credit risk for the bank as a whole.
 - (B) The Board performs daily loan audits and monitors the quality of every individual loan portfolio.
 - (C) The Board articulates aggregate risk limits and review mechanisms.
 - (D) The Board ensures its profit objective and capital planning are kept in view while deciding the risk level.

Oct/Nov 2019

59. Consider the following statements. Prudential limits may be specified for several aspects to

limit credit risk. Which of the following are included in these aspects?

- I. Prudential limits for credit exposure
- II. Prudential limits for asset concentration
- III. Prudential limits for large exposures
- IV. Prudential limit for maturity profile of the loan book
- V. Prudential limits for financial and profitability ratios

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, III, IV, and V

May/June 2009

60. Identify the INCORRECT statement concerning Collateralised Loan Obligations (CLOs) and Credit Linked Notes (CLNs).

- (A) A CLO provides credit exposure to a diverse pool of credits, whereas most credit-linked notes are linked to a single credit.
- (B) CLOs may provide a true transfer of ownership of underlying assets, whereas credit-linked notes typically do not provide such a transfer.
- (C) The rating of CLOs is strictly capped at the rating level of the originating institution, unlike credit-linked notes.
- (D) The collateral for a CLO usually resides in an SPV which issues several levels of debt such as senior, mezzanine, and subordinated tranches.

Oct/Nov 2011

61. Consider the following statements. Which of the following entities are eligible to act as market makers in credit derivatives, subject to specific conditions and approvals?

- I. Scheduled Commercial Banks (except Small Finance, Payment, Local Area, and RRBs)
- II. Standalone Primary Dealers (SPDs)
- III. National Housing Bank
- IV. Small Finance Banks
- V. Export Import Bank of India

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

May/June 2010

62. The credit risk management framework involves finding answers to four key questions. Which of the following is NOT one of those four key questions?

- (A) What are the risks?
- (B) How can we monitor and control credit risk?
- (C) How can we completely eliminate all risks from the lending portfolio?
- (D) Which, when and how much risk to accept that results in improving bottom-line?

Oct/Nov 2024

63. The following question consists of two statements — an Assertion (A) and a Reason (R).

Assertion (A): A 'B' rated borrower account would typically be priced at a level higher than that of an 'A' rated borrower account.

Reason (R): Lower-rated accounts exhibit a lower historical rate of default, allowing banks to charge a premium for superior credit quality.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2017

64. Prudential limits serve the purpose of limiting credit risk. Which of the following is NOT a typical prudential limit aspect?

- (A) Prudential limits for credit exposure
- (B) Prudential limits for asset concentration
- (C) Prudential limits for maturity profile of the loan book
- (D) Prudential limits for employee attrition rate

Oct/Nov 2005

65. The following question consists of two statements — an Assertion (A) and a Reason (R).

Assertion (A): A well-diversified credit portfolio reduces systematic risk to absolute zero.

Reason (R): Systematic risk is inherent to the market as a whole and generally viewed as being difficult to avoid.

- (A) Both Assertion (A) and Reason (R) are true,

and Reason (R) is the correct explanation of Assertion (A).

- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

66. Active credit portfolio management is motivated by new opportunities in the economy. Which of the following is NOT recognized as a new opportunity for active credit portfolio management?
 (A) Pass through certificates in case of securitization transactions
 (B) Syndicated lending
 (C) Retail deposits and savings accounts
 (D) Project/structured finance

Oct/Nov 2015

67. Consider the following scenario for Questions 67 to 69: A bank tracked the rating migration of 1,000 'A' rated borrower accounts over a one-year period. At the end of the year, the ratings were distributed as follows: 10 upgraded to A++, 25 upgraded to A+, 800 remained at A, 100 migrated to B++, 40 migrated to B+, 15 migrated to B, and the rest defaulted. How many 'A' rated borrower accounts defaulted during the one-year period?
 (A) 5 accounts
 (B) 10 accounts
 (C) 15 accounts
 (D) 20 accounts

May/June 2013

68. Why is the acceptability of a bank's rating model by regulatory authorities heavily dependent on mapping its rating migration with standard migration patterns?
 (A) Because it guarantees that the bank will never face a default event in its entire loan portfolio.
 (B) To ensure the model captures borrower risk sensitivity in line with accredited agency standards.
 (C) Because mapping eliminates the need for calculating expected and unexpected loan losses internally.
 (D) To allow the bank to bypass the capital adequacy requirements set by regulatory

authorities entirely.

Oct/Nov 2021

69. If the standard migration pattern observed by external rating agencies shows a 0.2% default probability for 'A' rated borrowers, how will regulatory authorities likely view the bank's internal rating model from the scenario?
 (A) Authorities will consider the bank's model conservative and award it a premium rating.
 (B) Authorities will ignore the internal model as mapping is optional for commercial banks.
 (C) Authorities will penalize agencies for publishing non-compliant standard migration patterns.
 (D) Authorities will assume the model fails to capture risk sensitivity and may assign a lower rating.

May/June 2024

70. What is the primary advantage for a bank extending a loan and simultaneously arranging a total return swap with a hedge fund investor to manage loan concentrations?
 (A) The bank fully transfers the loan asset to the hedge fund, removing it from its balance sheet.
 (B) The bank earns an upfront premium without having to pay any periodic returns to the investor.
 (C) It retains the customer, hedges the risk, and reduces regulatory capital requirements.
 (D) The bank eliminates all legal and operational risks associated with the original loan agreement.

Oct/Nov 2008

71. Based on the scenario provided, what is the MRR amount required for the loans with an original maturity of 36 months?
 (A) Rs. 40 Crores
 (B) Rs. 60 Crores
 (C) Rs. 80 Crores
 (D) Rs. 100 Crores

May/June 2006

72. Consider the debt tranches in a Collateralised Loan Obligation (CLO) structure. Arrange the following tranches in the order they are typically paid from the cash flows generated by the underlying collateral (from highest priority to lowest priority):

NODIA

- I. Mezzanine Tranche
- II. Subordinated Tranche
- III. Senior Tranche

- (A) I, II, III
- (B) III, I, II
- (C) III, II, I
- (D) I, III, II

Oct/Nov 2017

73. In this TRS arrangement, what does the bank swap with the hedge fund investor?
- (A) The asset's total actual return for a premium based on a benchmark rate plus a spread.
 - (B) The physical loan documentation and the legal ownership of the asset for a fixed cash payment.
 - (C) The periodic premium in return for protection strictly against the steel company's bankruptcy.
 - (D) The right to recall the loan before maturity in exchange for a specific clean-up call premium.

May/June 2008

74. Match the credit risk management bodies in List I with their specific responsibilities in List II.

List I: (Management Bodies)

- P. Board of Directors
- Q. Risk Management Committee
- R. Credit Policy Committee
- S. Credit Risk Management Department

List II: (Responsibilities)

1. Formulates policies on financial covenants and delegation of credit approving powers.
 2. Ensures robustness of measurement of risk models and sets guidelines for risk reporting.
 3. Enforces and monitors compliance of risk parameters and undertakes portfolio evaluations.
 4. Articulates aggregate risk limits and decides the overall level of credit risk keeping profit objective in view.
- (A) P-4, Q-2, R-1, S-3
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-4, Q-1, R-3, S-2
 - (D) P-2, Q-3, R-4, S-1

Oct/Nov 2013

75. If the steel company's loan represents a credit risk mitigation tool, why might the bank still be concerned about the TRS transaction?

- (A) Use of mitigation techniques may simultaneously increase legal, operational, and market risks.
- (B) Regulatory authorities strictly prohibit the use of TRS for manufacturing sector exposures.
- (C) Credit derivatives inherently require the transfer of the underlying asset from the bank's books.
- (D) The hedge fund investor automatically gains voting rights on the bank's Board of Directors.

May/June 2015

76. Match the Credit Risk Models in List I with their key features or developers in List II.

List I: (Credit Risk Models)

- P. Altman's Z Score
- Q. CreditMetrics
- R. CreditRisk+
- S. Credit Rating Model

List II: (Key Features)

1. Based on actuarial calculation of expected default rates and unexpected losses from default.
 2. Forecasts bankruptcy probability within a 12-month period using five financial ratios.
 3. Differentiates borrowers based on the degree of stability in terms of top-line and bottom-line revenue generation.
 4. Focuses on estimating the volatility in asset value caused by variations in asset quality, tracking rating migrations.
- (A) P-2, Q-4, R-1, S-3
 - (B) P-1, Q-2, R-3, S-4
 - (C) P-2, Q-3, R-4, S-1
 - (D) P-4, Q-1, R-2, S-3

Oct/Nov 2012

77. In the framework of Altman's model, what is the critical Z-score threshold below which a firm should be classified as a high-risk borrower?

- (A) 1.50
- (B) 1.81
- (C) 2.50
- (D) 3.00

May/June 2011

78. Match the Credit Derivatives in List I with their operational characteristics in List II.

List I: (Credit Derivative Types)

- P. Credit Default Swap (CDS)

- Q. Total Return Swap (TRS)
- R. Credit Linked Note (CLN)
- S. Credit Spread Option

List II: (Characteristics)

1. An on-balance sheet debt instrument with an embedded credit derivative, providing a dual risk to the investor.
2. Protects against an unfavourable migration of an asset by transferring risk in return for an upfront or periodic premium.
3. The protection buyer swaps actual return (coupon and capital appreciation) on an asset versus payment of a variable rate plus/minus a spread.
4. A transaction where the protection buyer pays a periodic premium for protection against a specified credit event on a reference obligation.

- (A) P-4, Q-3, R-1, S-2
- (B) P-3, Q-4, R-2, S-1
- (C) P-4, Q-1, R-3, S-2
- (D) P-1, Q-2, R-4, S-3

Oct/Nov 2020

79. In the regulatory formula to compute exposure value after risk mitigation, what is the value representing the exposure adjusted for the haircut?
- (A) Rs. 400 crores
 - (B) Rs. 432 crores
 - (C) Rs. 468 crores
 - (D) Rs. 500 crores

May/June 2022

80. Which of the following pairs correctly maps the motive for entering into a credit derivative with the respective party?
- (A) Speculation — This is primarily the motive for the Protection Buyer in a credit derivative transaction.
 - (B) Transferring risk without the asset — This is the motive for the Protection Seller in a credit derivative transaction.
 - (C) Hedging against credit risks — This is the primary motive for the Protection Seller in a credit derivative transaction.
 - (D) Relief in regulatory capital — This is a primary motive for the Protection Buyer in a credit derivative transaction.

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relationship. By transferring the credit and market risk to an investor, the bank effectively hedges its position and can reduce the amount of regulatory capital it is required to hold. This provides a balance between business growth and risk management.

35. (A) P-3, Q-4, R-1, S-2

Default risk is driven by a borrower's failure to make promised payments, whereas downgrade risk involves a worsening of credit quality without actual failure. Systematic risk reflects inherent market factors like economic or geopolitical shifts. Concentration risk arises when a portfolio is heavily weighted toward specific borrowers or industries. Understanding these distinctions is crucial for comprehensive risk identification and management.

36. (C) 1.915

Calculating Altman's Z-score involves applying specific weights to five key financial ratios to evaluate a firm's financial health. For the firm in the provided scenario, using the formula results in a Z-score of one point nine one five. This quantitative measure helps banks categorize borrowers by their probability of bankruptcy, providing a standardized method for assessing credit risk in manufacturing.

37. (A) P-1, Q-4, R-3, S-2

A clean-up call is an option to call securitisation exposures before full repayment, while credit enhancement provides added protection to investors. Asset-backed commercial paper involves short-term paper issued by a bankruptcy-remote entity. The minimum retention requirement ensures that originators maintain a continuing stake in the performance of the securitised assets, aligning their interests with those of the investors.

38. (C) Classified as not a high-risk borrower due to a Z-score above 1.81, indicating lower risk.
In Altman's Z-score model, a threshold of one point eight one is typically used to distinguish between different levels of bankruptcy risk. Since the firm's calculated Z-score of one point nine one five is higher than this critical threshold, it is classified as not being a high-risk borrower. This score indicates a relatively lower probability of default within the next year.

39. (B) Residential mortgage-backed securities — MRR shall be 5% of the book value regardless of original maturity.

Under standard regulatory guidelines, residential mortgage-backed securities have a specific minimum retention requirement set at five percent of the book value of the loans. This requirement remains constant regardless of the original maturity of the underlying mortgages. In contrast, other types of loans may have different retention percentages depending on their specific characteristics and original maturity periods.

40. (B) Rs. 425 crores

To determine the protective value of collateral in a transaction, the current market value must be adjusted by an appropriate haircut. In this instance, a fifteen percent haircut is applied to the five hundred crore rupee collateral. This calculation results in an adjusted collateral value of four hundred and twenty-five crore rupees, which is then used to calculate net exposure.

41. (A) Top management information — To provide top management with information on marketing strategies and recruitment.

The loan review mechanism is designed to provide top management with critical information regarding the quality of the loan portfolio and the effectiveness of credit policies. However, it does not focus on marketing strategies or recruitment processes. Instead, its primary objectives include identifying potential problem areas, ensuring the adequacy of loan loss provisions, and initiating timely corrective actions.

42. (B) It occurs when a borrower defaults on interest or principal installment payments when due.

Credit risk is fundamentally defined as the possibility of loss resulting from a borrower's failure to repay a loan or meet contractual obligations. It primarily arises in lending activities when a borrower defaults on interest payments or principal installments when they become due. Managing this risk is central to a bank's stability and involves assessing the creditworthiness of all counterparties.

43. (A) Only I is correct

Expected loan losses represent the average amount of loss a bank anticipates experiencing over a specific time horizon based on historical

only, as physical delivery of the reference asset is also common.

9. (A) Haircut appropriate to the exposure

In the calculation of exposure value for collateralised transactions, the component representing the haircut appropriate to the exposure accounts for potential price volatility. This adjustment ensures that the exposure value is prudently estimated during the risk mitigation process. Accurate application of these haircuts allows banks to determine the net exposure after considering the protective value of the received collateral.

10. (A) I and II only

Credit linked notes are on-balance sheet debt instruments that allow credit risk to be distributed to a broader market of investors. Investors in these instruments face a dual risk involving both the issuer of the note and the reference obligation. Unlike credit default swaps, these notes are funded exposures, meaning the investor provides the full principal amount upfront.

11. (A) Systematic risk is inherent to the whole market, while concentration risk arises from a lack of diversification.

Systematic or intrinsic risk refers to factors inherent to the entire market, such as geopolitical or economic shifts, which are difficult to avoid. Conversely, concentration risk arises specifically from a lack of diversification within a portfolio, occurring when there is excessive exposure to a single borrower, industry, or region. While diversification reduces concentration risk, systematic risk typically persists.

12. (D) I, II, III, and IV

Maintaining portfolio quality involves strategic measures including setting quantitative ceilings on specific rating categories and monitoring performance across various industries and sectors. Implementing discriminatory time schedules for borrower reviews and targeting expected defaults for prudent provisioning further strengthen the framework. These activities collectively ensure that the bank identifies potential weaknesses early and maintains a healthy, well-diversified credit profile.

13. (B) Traditional uses pool cash flows to service risk positions, while synthetic transfers risk via derivatives.

Traditional securitisation involves the physical transfer of assets to a special purpose vehicle, which uses the resulting cash flows to service risk positions. Synthetic securitisation differs by using credit derivatives or guarantees to transfer the credit risk of a pool of assets without moving the assets themselves. This method allows institutions to manage risk while retaining assets on-balance sheet.

14. (A) I, II, and III only

Protection sellers in the credit derivative market are typically motivated by opportunities for yield enhancement and the potential for speculation. They also use these instruments to achieve diversification of their existing credit risk portfolios. While protection buyers seek to hedge risks and reduce capital requirements, sellers focus on earning premiums by assuming risks that align with their overall strategy.

15. (D) CDS involves the buyer paying a premium for protection against a credit event on a reference obligation.

A credit default swap is a financial contract where the protection buyer pays a periodic premium to the protection seller. In exchange, the seller agrees to compensate the buyer if a specified credit event occurs on a reference obligation. This mechanism allows the buyer to transfer the credit risk of a principal asset without physically selling the underlying instrument.

16. (D) I, II, III, and IV

The transition to active credit portfolio management involves utilizing diverse tools such as secondary loan trading, securitisation, and credit derivatives to manage exposures. Additionally, organizational readiness through human resource training and the selection of appropriate analytical systems is vital. These components work together to enable banks to dynamically adjust their portfolios in response to changing market conditions.

- 17.** (B) The buyer delivers the reference obligation to the seller in exchange for the notional amount of the swap.
Physical settlement in a credit derivative transaction involves the protection buyer delivering the defaulted reference obligation to the protection seller. In return, the seller pays the buyer the full notional amount or par value of the swap. This process transfers the actual distressed asset to the seller, who then assumes the recovery process and any remaining residual value.
- 18.** (D) I, II, III, IV, and V
Regulatory authorities evaluate the acceptability of internal rating models based on their inclusion of critical risk drivers. These factors encompass management quality, financial performance, past conduct, business-related issues, and industry environment. A comprehensive model that incorporates these diverse elements provides a more accurate assessment of a borrower's creditworthiness and ensures the bank's risk measurements are sufficiently robust.
- 19.** (A) Loan Review Officers report to the Credit Administration Department instead of the Board of Directors.
The loan review mechanism is an independent function intended to evaluate the effectiveness of loan administration and credit grading. To ensure objectivity and independence, loan review officers should ideally report to a high-level committee or top management, but not to the department responsible for credit administration. This separation helps maintain the integrity and transparency of the audit process.
- 20.** (B) I, III, IV, and V only
Portfolio-level credit control involves identifying weaknesses through credit quality migrations and evaluating exposure distributions across different rating categories and industries. This framework includes setting quantitative ceilings and moving toward sophisticated credit portfolio value at risk models. Unlike transaction-level management, it focuses on the aggregate risk profile and the interaction between different exposures to maintain overall health.
- 21.** (D) They can only be exercised in European style and must be physically settled.
Credit spread options allow hedgers to protect against unfavorable migration or widening of an asset's credit spread. These instruments can be exercised within a specified period at a pre-set strike price or spread. Contrary to restrictive assumptions, they can be designed with either European or American exercise styles and are typically settled in cash rather than requiring physical delivery.
- 22.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Loans held in the banking book are generally exempt from the mark-to-market process because they are typically held until maturity. In this context, the primary concern is whether a borrower is currently in default, as default represents the immediate credit event causing loss. This focus on actual default events distinguishes the banking book's accounting treatment from the trading book.
- 23.** (B) Geopolitical Parameter
The standard credit rating process evaluates a borrower based on specific parameters such as financial health, management quality, and industry conditions. While geopolitical factors influence the overall market environment, they are not typically treated as a standalone parameter for rating individual corporate entities. Focus remains on the borrower's direct operational ability to meet debt obligations and maintain financial stability.
- 24.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
Utilizing credit risk mitigation techniques effectively transfers credit risk but can simultaneously introduce secondary risks like legal, operational, and liquidity concerns. Banks must employ robust procedures to monitor and control these collateral-related risks. While the need for control is a logical consequence, it does not explain why the mitigation process itself inherently creates these additional risk exposures.

- 25.** (A) Resident companies with a minimum audited net worth of exactly Rs. 100 crore.
Eligibility for classification as a non-retail user in credit derivative contracts is strictly defined by regulatory authorities to ensure participants have sufficient financial sophistication. Regulated entities like mutual funds, insurance companies, and pension funds are typically eligible. However, a resident company must meet a specific minimum audited net worth threshold, which is generally much higher than exactly one hundred crore.
- 26.** (D) Assertion (A) is false, but Reason (R) is true.
In a total return swap, the protection buyer is protected against both credit and market risks, including changes in the principal value of the asset. The reason provided is true in that the total actual return captures the full economic performance, including capital appreciation or depreciation. Therefore, the assertion claiming the principal is not covered is factually incorrect.
- 27.** (A) To align risk and business policies for consistent implementation across the bank.
The primary objective of establishing an organizational structure for credit risk management is to align the bank's risk and business policies. This alignment ensures that risk strategies are consistently implemented throughout the institution. By centralizing the framework, banks can effectively manage their risk appetite while pursuing profit goals, creating a unified approach to identifying and monitoring credit exposures.
- 28.** (B) 1.0%
Based on the migration data of one thousand 'A' rated borrowers, ten accounts were found to have defaulted by the end of the year. This figure is derived by subtracting the total number of upgraded, remaining, and downgraded accounts from the initial pool. Consequently, the default probability for this specific rating category over a one-year period is exactly one percent.
- 29.** (B) Because it fails to signal overall loan book quality or identify weaknesses well in advance.
Tracking non-performing loans solely around the balance sheet date is insufficient because it provides a lagging indicator of credit quality. This practice fails to provide early warning signals or identify emerging weaknesses in the loan book well in advance. Effective portfolio management requires continuous monitoring of credit migrations and quality changes to proactively address potential defaults before they occur.
- 30.** (B) Rs. 25 Crores
For loans with an original maturity of twenty-four months or less, the minimum retention requirement is set at five percent of the book value of the loans being securitised. In this scenario, applying five percent to the five hundred crore rupee pool results in a required retention of twenty-five crore rupees. This ensures the originator maintains a continuing stake.
- 31.** (C) 30–40%
To ensure the effectiveness of the loan review mechanism, regulatory and internal guidelines recommend that a significant portion of the credit portfolio be reviewed annually. Specifically, between thirty and forty percent of the total portfolio should be subjected to this process. This frequency allows the bank to maintain oversight over its lending activities and ensure the integrity of its grading.
- 32.** (D) Senior Tranche
In a collateralised loan obligation structure, the senior tranche is the most protected layer and has the highest priority for payments from the underlying pool's cash flows. Because the equity and mezzanine tranches absorb the first losses, the senior tranche is the most likely to withstand high levels of default without interrupting its contractual payments to the various investors.
- 33.** (A) II, I, IV, III
The chronological sequence of a credit default swap begins with the protection buyer paying periodic premiums under the initial agreement. If a specified credit event occurs, a notice is generated to trigger the settlement. The buyer then delivers the distressed reference asset to the seller, who subsequently pays the buyer the full par value plus any accrued interest.
- 34.** (C) It retains the customer, hedges risk, and reduces the required regulatory capital.
Arranging a total return swap allows a bank to manage its exposure to a specific sector while maintaining the underlying customer

ANSWERS

1. (B) Rs. 7 crores
The net exposure value after risk mitigation is calculated using a regulatory formula that adjusts both the exposure and the collateral by specific haircuts. In this scenario, the exposure of four hundred crore rupees is increased by an eight percent haircut, while the five hundred crore rupee collateral is decreased by a fifteen percent haircut, resulting in seven crores.
2. (C) Concentration Risk — Counterparty risk variant
Concentration risk arises when a portfolio has higher weight in respect of a borrower, geography, or industry. It is a component of portfolio risk rather than a simple transaction-level counterparty risk variant. Effective credit risk management requires identifying such imbalances to ensure proper diversification across various sectors and segments. This categorization helps banks manage the aggregate stability of their book.
3. (A) Risk of credit quality deterioration for a non-defaulting borrower, usually seen through a rating downgrade.
Credit spread risk, often called downgrade risk, reflects the possibility of credit quality deterioration for a borrower who has not yet defaulted. This is typically observed through a formal rating downgrade by agencies. It signifies an increased probability of default, leading to a widening of the credit spread and a decrease in the asset market value for the holding institution.
4. (A) Only I is correct
Standardised credit events in derivative contracts include bankruptcy, obligation acceleration, obligation default, failure to pay, repudiation or moratorium, and restructuring. These events trigger the settlement process between parties. While documentation is standardised by international bodies, credit derivatives are primarily over-the-counter bilateral contracts rather than exchange-traded instruments, allowing for customized risk transfer between specific counterparties to occur effectively.
5. (D) An OTC bilateral contract transferring credit asset risks without necessarily transferring the underlying asset.
A credit derivative is an over-the-counter bilateral contract that facilitates the transfer of credit risk associated with a specific asset without requiring the physical transfer of that asset. This allows institutions to manage exposure to potential defaults or rating downgrades while maintaining the underlying lending relationship and keeping the original asset on their balance sheets for accounting purposes.
6. (B) Only II is correct
Regulatory guidelines for credit default swaps specify that reference obligations are generally restricted to money market instruments and rated corporate bonds. However, asset-backed securities, mortgage-backed securities, and convertible bonds are explicitly excluded from being permitted as reference obligations. This restriction ensures that the underlying credit risk being traded remains transparent and manageable within the established derivative framework.
7. (B) 3 or 4 officers
Credit approving authority guidelines emphasize a shift from individual decision-making to a collective committee approach. An effective approval grid or committee must comprise at least three or four officers to ensure diverse perspectives and rigorous evaluation. This structure enhances the integrity of the credit sanctioning process, reducing the risk of biased judgments or oversight in complex corporate lending transactions.
- (A) I and II only
Successful transaction documentation in credit derivatives requires a clear presentation of term sheets by the trading team to ensure all terms are unambiguous. A collaborative problem-solving approach between the trading desk, end-users, and internal partners is essential for accuracy. Settlement methods are not restricted to cash

data. Conversely, unexpected loan losses represent the risk that actual losses will exceed these expected levels due to volatility or unforeseen events. Managing both types of loss is essential for determining capital requirements and establishing appropriate loan loss reserves.

44. (C) The conversion of illiquid long-term loans into tradable short-term bonds via a Special Purpose Vehicle.

Securitisation is the financial process of pooling various types of contractual debt, such as loans or mortgages, and selling their related cash flows to third-party investors as securities. This process typically involves a special purpose vehicle and converts illiquid long-term assets into tradable short-term bonds. It allows banks to remove assets from their balance sheets and free up capital.

45. (A) Only I is correct

Small value retail loan accounts are typically managed efficiently by subjecting them to review on an exception basis rather than individual scrutiny. This approach allows banks to focus resources on segments showing signs of weakness or above-average default rates. By identifying these specific underperforming areas, the bank can implement remedial actions and adjust lending criteria to maintain portfolio health.

46. (D) 10% of the book value of the loans being securitised

For securitisation transactions involving underlying loans with an original maturity exceeding twenty-four months, the minimum retention requirement is ten percent of the book value. This regulatory standard ensures that originators retain a significant interest in the credit quality of longer-term assets. This requirement helps mitigate moral hazard and encourages prudent underwriting standards throughout the life of the loans.

47. (D) I, II, and III

The motivation for moving toward active credit portfolio management is driven by shifts in the traditional lending market, including disintermediation and increased capital mobility. Furthermore, lower returns on traditional products and the heightened importance of risk management necessitate a more dynamic

approach. These factors encourage banks to utilize sophisticated tools to optimize their risk-return profiles and manage exposures.

48. (D) Retained earnings/Total assets ratio

In Altman's Z-score model for manufacturing firms, the variable designated as X2 represents the ratio of retained earnings to total assets. This ratio measures the firm's cumulative profitability over time and its ability to finance assets using internally generated funds. It is a critical indicator of financial stability, as firms with higher retained earnings generally have a lower risk of bankruptcy.

49. (B) I and III only

Credit rating standards require that updates to internal ratings occur at least at half-yearly or quarterly intervals to reflect the current risk profile of borrowers. The responsibility for confirming these ratings should be independent of the loan officers, ideally vested with a dedicated loan review function. These practices ensure that the bank assessment of credit risk remains accurate and objective.

50. (C) Lower-rated accounts should be priced higher than higher-rated ones to cover the increased cost of default.

The concept of risk-reward parity in loan pricing dictates that the interest rate charged to a borrower should reflect their specific risk profile. Under this principle, lower-rated accounts, which have a higher probability of default, are priced higher than higher-rated ones. This ensures the bank is adequately compensated for the increased cost of potential losses and higher capital requirements.

51. (A) I and II only

Diversification in a credit portfolio is achieved by spreading exposure across different borrowers, industries, and geographical regions. A well-diversified portfolio reduces the concentration of risk, meaning the capital required to cover potential defaults is only a fraction of the total exposure. However, even with extensive diversification, systematic risk inherent to the entire market cannot be completely eliminated and managed.

- 69.** (D) Authorities will assume the model fails to capture risk sensitivity and may assign a lower rating.

If a bank's internal model shows a significantly higher default probability than the standard migration patterns observed by external agencies, regulatory authorities will likely question the model's accuracy. In this scenario, the bank's one percent default rate is much higher than the agency zero point two percent. Consequently, the authorities may conclude the model fails to properly capture sensitivity.

- 70.** (C) It retains the customer, hedges the risk, and reduces regulatory capital requirements.

Using a total return swap allows a bank to manage its exposure to a specific client while maintaining the primary lending relationship. By transferring the credit and market risks to an investor like a hedge fund, the bank effectively hedges its position. This strategy enables the bank to reduce its regulatory capital requirements without having to physically sell the asset.

- 71.** (C) Rs. 80 Crores

For loans with an original maturity exceeding twenty-four months, the minimum retention requirement is set at ten percent of the book value of the loans being securitised. In the provided scenario, applying this ten percent requirement to the eight hundred crore rupee pool results in a required retention of eighty crore rupees. This ensures the originator maintains a continuing stake.

- 72.** (B) III, I, II

In a collateralised loan obligation, cash flows from the underlying assets are distributed to investors according to a specific priority known as a waterfall. The senior tranche has the highest priority and is paid first. This is followed by the mezzanine tranche, and finally, the subordinated or equity tranche receives any remaining funds, assuming all higher-priority obligations are met.

- 73.** (A) The asset's total actual return for a premium based on a benchmark rate plus a spread.

In a total return swap, the bank agrees to pay the protection seller the total actual return of the reference asset, which includes coupons and any capital appreciation. In exchange, the bank receives a payment based on a floating

benchmark rate plus or minus a pre-determined spread. This arrangement transfers the economic risks and rewards of the asset to the seller.

- 74.** (A) P-4, Q-2, R-1, S-3

The Board of Directors sets aggregate risk limits and decides the overall level of credit risk. The Risk Management Committee ensures the robustness of measurement models, while the Credit Policy Committee formulates standards for covenants and approval powers. Finally, the Credit Risk Management Department is responsible for monitoring compliance with risk parameters and performing evaluations to maintain health.

- 75.** (A) Use of mitigation techniques may simultaneously increase legal, operational, and market risks.

While credit risk mitigation tools like total return swaps can effectively transfer credit risk, they may simultaneously introduce or increase other types of risks. These include potential legal challenges, operational failures, and market volatility. Banks must be aware of these secondary risks and implement robust procedures to manage them, ensuring the overall strategy does not create new vulnerabilities for the institution.

- 76.** (A) P-2, Q-4, R-1, S-3

Altman's Z-score forecasts bankruptcy using financial ratios, while CreditMetrics tracks asset value volatility through rating migrations. CreditRisk+ uses actuarial calculations of default rates to estimate losses. Standard credit rating models differentiate borrowers based on their financial stability and revenue generation. Together, these models provide a comprehensive toolkit for banks to measure and manage different aspects of credit risk within portfolios.

- 77.** (B) 1.81

In the application of Altman's Z-score model for manufacturing firms, a score of one point eight one serves as the critical threshold for identifying high-risk borrowers. Firms with a Z-score falling below this level are classified as being in a distressed zone with a high probability of bankruptcy. This threshold allows banks to apply standardized quantitative criteria during assessment.

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- 60.** (C) The rating of CLOs is strictly capped at the rating level of the originating institution, unlike credit-linked notes.

Collateralised loan obligations involve a pool of credits and often provide a true transfer of ownership through a special purpose vehicle. In contrast, credit linked notes are typically linked to a single credit and are on-balance sheet items. It is incorrect to state that CLO ratings are strictly capped at the originator's rating, as credit enhancement techniques allow for higher ratings.

- 61.** (A) I, II, III, and V only

Market makers in credit derivatives include scheduled commercial banks and standalone primary dealers, subject to specific regulatory conditions. Other eligible entities include the National Housing Bank and the Export Import Bank of India. However, certain types of banks, such as small finance banks, payment banks, and regional rural banks, are generally excluded from acting as market makers in these instruments.

- 62.** (C) How can we completely eliminate all risks from the lending portfolio?

The credit risk management framework focuses on identifying, measuring, monitoring, and controlling risk to improve the bottom line. It addresses questions regarding the nature of risks and the best methods to manage them while deciding which risks to accept. It is not an objective of the framework to completely eliminate all risks, as taking calculated risks is fundamental.

- 63.** (C) Assertion (A) is true, but Reason (R) is false. A borrower with a lower credit rating is typically charged a higher interest rate than one with a superior rating. This pricing reflects the increased risk of loss associated with lower-rated accounts. The reason provided is false because lower-rated borrowers historically exhibit higher default rates, not lower, which is precisely why banks must charge a higher premium to compensate.

- 64.** (D) Prudential limits for employee attrition rate
Prudential limits are designed to control financial risks and ensure the stability of the bank's lending portfolio. Common limits focus on credit exposure, asset concentration, and the maturity profile of the loan book. While

employee attrition is an operational concern for human resources, it is not a standard prudential limit used specifically for managing credit risk within the bank portfolio.

- 65.** (D) Assertion (A) is false, but Reason (R) is true. While diversification is a powerful tool for reducing concentration risk, it cannot reduce systematic risk to zero. Systematic risk is inherent to the entire market and is driven by broad economic or geopolitical factors that affect all participants. Therefore, the assertion that systematic risk can be completely eliminated is incorrect, even though the description of its nature is accurate.

- 66.** (C) Retail deposits and savings accounts
Active credit portfolio management is enabled by financial innovations such as securitisation, pass-through certificates, syndicated lending, and structured finance. These opportunities allow banks to manage their credit exposures more dynamically. In contrast, traditional retail deposits and savings accounts are primary sources of funding but do not represent new opportunities for the active management of credit risk in lending.

- 67.** (B) 10 accounts
To find the number of defaults among the initial one thousand 'A' rated borrower accounts, we subtract all accounts that were upgraded, remained at the same rating, or were downgraded. The total of these non-defaulted accounts is nine hundred and ninety. Subtracting this from the original pool of one thousand reveals that exactly ten accounts defaulted over the year.

- 68.** (B) To ensure the model captures borrower risk sensitivity in line with accredited agency standards.

Regulatory authorities require banks to map their internal rating migrations against standard patterns to ensure that their models accurately capture borrower risk sensitivity. This alignment ensures that the bank's internal assessments are consistent with recognized industry standards provided by accredited agencies. Effective mapping confirms that the rating model is robust enough to provide reliable data for capital adequacy requirements.

List I: (Event-based classification)

- P. Internal Fraud
- Q. External Fraud
- R. Clients, Products and Business Practices
- S. Business Disruption and System Failures

List II: (Description)

- 1. Losses from unintentional failure to meet a professional obligation to specific clients.
- 2. Losses arising from disruption of business operations.
- 3. Losses due to acts intended to defraud by a third party.
- 4. Losses due to acts intended to defraud involving at least one internal party.

- (A) P-4, Q-3, R-1, S-2
- (B) P-3, Q-4, R-2, S-1
- (C) P-4, Q-1, R-3, S-2
- (D) P-1, Q-2, R-4, S-3

Oct/Nov 2012

14. Conceptually, why is the net effect of all risks in an organization not strictly the same as the simple sum total of all individual risks?
- (A) Because operational risks cannot be quantified accurately in financial terms.
 - (B) Because regulatory guidelines mandate different capital adequacy ratios for each risk type regardless of size.
 - (C) Because of diversification effects for similar risks and the interplay between various types of risk.
 - (D) Because market risk inherently negates credit risk under all economic scenarios.

May/June 2022

15. Consider the following scenario: A bank faces financial losses because its back-office operations mistakenly wired funds to an incorrect vendor account due to a data entry error, and the relationship with the trade counterparty was subsequently strained. Under which event type is this categorized?
- (A) Internal Fraud
 - (B) Clients, products and business practices
 - (C) Employment practices and workplace safety
 - (D) Execution, delivery and process management

Oct/Nov 2008

16. Consider the following statements regarding the benefits of a standardized, integrated approach to risk management for financial institutions:

- I. Aligning the strategic aspects of risk with day-to-day operational activities.
 - II. Generating greater transparency for investors and regulators.
 - III. Guaranteeing the complete elimination of downside risk potential.
 - IV. Enhancing revenue and earnings growth.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) II, III, and IV only
 - (C) I, II, and IV only
 - (D) I, III, and IV only

May/June 2014

17. Which option most appropriately describes the intent of the principle regarding fundamental corporate culture in Operational Risk Management?
- (A) Developing an IT framework that is fully integrated into the bank's overall internal audit and compliance processes.
 - (B) Establishing a strong risk management culture with appropriate standards and incentives for professional behavior.
 - (C) Implementing public disclosures that allow external stakeholders to assess the bank's capital allocation metrics.
 - (D) Ensuring business resiliency and continuity plans remain active in the event of severe internal or external disruptions.

Oct/Nov 2020

18. Which of the following is NOT categorized as a "Business Challenge" influencing integrated risk management?
- (A) Constant evolution and shifting of the real-time business environment.
 - (B) Continuous and accelerating pace of modern technological change.
 - (C) Presence of stand-alone legacy systems making workflow connectivity impossible.
 - (D) The need to limit earnings' volatility and enhance shareholder value.

May/June 2019

19. Consider the following areas relevant to an effective Operational Risk Management policy:
- I. Operational risk management structure
 - II. Role and responsibilities
 - III. Operational risk management processes
 - IV. Operational risk assessment/measurement methodologies

78. (A) P-4, Q-3, R-1, S-2

A credit default swap involves paying premiums for protection against specific credit events, while a total return swap involves exchanging an asset's total return for a variable rate payment. Credit linked notes are on-balance sheet instruments with embedded derivatives. Credit spread options protect against unfavorable migration of an asset spread. These various instruments offer different ways to manage credit risk.

79. (B) Rs. 432 crores

To calculate the exposure value in a collateralised transaction, the initial exposure must be adjusted using a specific haircut that accounts for potential price volatility. In this scenario, applying an eight percent haircut to the four hundred crore rupee exposure results in an adjusted value of four hundred and thirty-two crore rupees. This figure is then used for net exposure calculation.

80. (D) Relief in regulatory capital — This is a primary motive for the Protection Buyer in a credit derivative transaction.

Different parties have distinct motivations for participating in the credit derivative market. Protection buyers are primarily motivated by the desire to hedge against credit risks and achieve relief in their regulatory capital requirements. On the other hand, protection sellers are often motivated by yield enhancement and diversification. Correctly matching these motives helps in understanding the dynamics of risk transfer.

- 52.** (D) Estimating asset value volatility by tracking rating migrations and variations in the underlying credit quality.

The CreditMetrics model is a sophisticated tool that evaluates credit risk by focusing on the volatility of asset values. It achieves this by tracking the migration of credit ratings and assessing how these changes impact the market value of the underlying assets. This approach allows banks to measure the risk of both default and credit quality deterioration within a framework.

- 53.** (B) I, II, and IV only

The depth of loan reviews under a loan review mechanism should focus on critical areas such as adherence to internal policies and the sufficiency of loan documentation. Additionally, reviews must evaluate the accuracy and timeliness of credit ratings assigned to borrowers. These focus areas ensure that credit administration is effective and that the bank internal risk assessments remain reliable.

- 54.** (C) It sets credit policy standards, financial covenants, and procedures for presenting credit proposals.

The Credit Policy Committee is responsible for establishing the bank's credit policy standards, including financial covenants and documentation requirements. It also defines the procedures for presenting credit proposals and sets the framework for delegating credit approving powers. By performing these functions, the committee ensures that the bank's lending activities are governed by a clear, consistent, and prudent set of rules.

- 55.** (A) I, II, and III only

Both external and internal factors can significantly impact the credit risk of a bank's portfolio. External factors include volatility in commodity prices and exchange rates, while internal factors involve the absence of prudential concentration limits and excessive reliance on collateral. Inadequate risk pricing also contributes to increased vulnerability. Identifying these factors allows banks to implement more effective risk management strategies.

- 56.** (A) A TRS swaps an asset's total return for a premium, transferring credit and market risks without physical lending.

A total return swap is a credit derivative that allows the protection buyer to swap the total actual return of an asset for a benchmark-based payment. This effectively transfers both the credit and market risk of the reference asset to the protection seller without requiring a physical sale. The seller gains exposure to the asset's economic performance, including coupons and price changes.

- 57.** (A) I, II, III, and IV only

Managing credit risk at the individual transaction level involves several key instruments, including the credit appraisal and risk analysis processes. Additionally, monitoring procedures and the loan review mechanism provide oversight throughout the life of the credit. These transaction-specific tools are distinct from portfolio-level models, which focus on the aggregate risk and the interaction of multiple exposures within the book.

- 58.** (B) The Board performs daily loan audits and monitors the quality of every individual loan portfolio.

The Board of Directors is responsible for setting the bank's overall risk appetite, articulating aggregate risk limits, and ensuring that capital planning aligns with profit objectives. However, it is not the Board's role to perform daily loan audits or monitor every individual loan portfolio. These operational tasks are delegated to specific departments and committees that report their findings regularly.

- 59.** (D) I, II, III, IV, and V

Prudential limits are essential tools for managing credit risk and are applied to various aspects of a bank's operations. These include limits on aggregate credit exposure, asset concentration, and large exposures to single or grouped entities. Limits are also set for the maturity profile of the loan book and critical financial ratios. Together, these boundaries prevent excessive risk-taking and promote stability.

- (C) Scenario Analysis
- (D) Key Risk Indicator (KRI) mapping

May/June 2013

7. Match the Cause-based classifications in List-I with their corresponding examples in List-II.

List I: (Cause-based classifications)

- P. People oriented causes
- Q. Process oriented (Transaction based) causes
- R. Process oriented (Operational control based) causes
- S. External causes

List II: (Examples)

- 1. Natural disasters, deteriorated social or political context
- 2. Negligence, incompetence, key man risk
- 3. Business volume fluctuation, product complexity
- 4. Inadequate segregation of duties, lack of management supervision

- (A) P-2, Q-3, R-4, S-1
- (B) P-4, Q-2, R-3, S-1
- (C) P-2, Q-4, R-3, S-1
- (D) P-3, Q-1, R-4, S-2

Oct/Nov 2017

8. Place the chronological steps of utilizing a Risk and Control Self-Assessment (RCSA) process in the correct order:

- I. Use frequency and severity values to generate a risk profile for the unit.
- II. Identify gaps between risks, existing controls, and effectiveness of controls.
- III. Suggest an action plan or come out with preventive measures to overcome weaknesses.

Which of the following is the correct sequence?

- (A) II, I, III
- (B) I, II, III
- (C) III, II, I
- (D) II, III, I

May/June 2021

9. Consider the following categories of operational risk events:

- I. Internal Fraud
- II. External Fraud
- III. Damage to physical assets
- IV. Execution, delivery and process management
- V. Business disruption and system failures

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, III, IV, and V

Oct/Nov 2006

10. Which of the following most appropriately describes a Key Risk Indicator (KRI)?

- (A) A retroactive audit mechanism designed to penalize employees for negligence.
- (B) A variable that provides a reliable basis for estimating the loss corresponding to a risk.
- (C) A broad market indicator that assesses the systemic liquidity of the entire banking sector.
- (D) A regulatory penalty framework implemented by supervisors for non-compliance.

May/June 2011

11. Which of the following describes the definition of the event classification "Employment Practices and Work Place Safety"?

- (A) Losses from acts inconsistent with employment or safety laws, personal injury claims, or diversity/discrimination events.
- (B) Losses due to acts intended to defraud, misappropriate property, or circumvent the law by an unauthorized third party.
- (C) Losses arising from an unintentional or negligent failure to meet a specific professional obligation to diverse clients.
- (D) Losses from failed transaction processing or process management, from relations with trade counterparties and vendors.

Oct/Nov 2024

12. Branch managers notice a sudden spike in customer complaints indicating a perceived lack of service quality. The management identifies that if this continues, customers may switch to another bank resulting in loss of business. In the context of risk measurement parameters, what does this spike in complaints represent?

- (A) Scenario Analysis Output
- (B) External Loss Data
- (C) Key Risk Indicator (KRI)
- (D) Risk and Control Self-Assessment (RCSA)

May/June 2007

13. Match the Event-based classification in List-I with its description in List-II.

NODIA

Oct/Nov 2019

26. Consider the following requirements for banks regarding the organizational component of the Integrated Risk Management Approach:
- Appoint a Chief Risk Officer (CRO).
 - Lay down a Board-approved policy defining the role and responsibilities of the CRO.
 - Mandate the CRO to control and co-ordinate the functions of the Risk Management Department.
 - Require the CRO to report directly to the MD or CEO of the Bank.
- Which of the above statement(s) is/are correct?
- I, II, and III only
 - I, II, and IV only
 - II, III, and IV only
 - I, II, III, and IV

May/June 2010

27. Which of the following is a correct statement regarding the Basic Indicator Approach (BIA)?
- Figures for years with negative or zero annual gross income should be excluded from the numerator and denominator.
 - Gross income should be reported net of operating expenses to accurately reflect the bank's total capital needs.
 - The Basic Indicator Approach requires a fixed percentage of 12% of positive annual gross income as a capital charge.
 - Provisions for unpaid interest or loan losses should be deducted from the bank's gross income calculations.

Oct/Nov 2015

28. Consider the following scenario: To comply with regulatory guidelines aiming to bring uniformity in risk management, a bank appoints a new Chief Risk Officer (CRO). To ensure the importance of the post and operational independence, to whom must the CRO report?
- The Head of Internal Audit
 - The Operational Risk Management Committee (ORMC)
 - The MD or CEO of the Bank
 - The Chairman of the national banking association

May/June 2006

29. A bank wishes to calculate its Gross Income for the Basic Indicator Approach. Its Operating Profit is ₹600 crore. The expenditure incurred

under Schedule 16 is ₹150 crore. Profit on HTM transactions is ₹50 crore, and irregular non-banking transaction income is ₹20 crore. What is the Gross Income based on these figures?

- ₹750 crore
- ₹730 crore
- ₹680 crore
- ₹700 crore

Oct/Nov 2025

30. Revised directions for the standardized approach for operational risk are applicable to most scheduled commercial banks. Which of the following bank types is NOT excluded from this ambit?
- Local Area Banks
 - Payments Banks
 - Private Sector Scheduled Commercial Banks
 - Small Finance Banks

May/June 2017

31. Match the Business Lines under the Standardised Approach in List-I with their assigned Beta Factors in List-II.
- List I: (Business Lines)
- Trading and Sales
 - Asset Management
 - Agency Services
 - Commercial Banking
- List II: (Beta Factors)
- 12%
 - 15%
 - 18%
 - 20%
- P-3, Q-1, R-2, S-2
 - P-3, Q-2, R-1, S-2
 - P-2, Q-1, R-3, S-3
 - P-1, Q-2, R-3, S-3

Oct/Nov 2010

32. Match the elements of the standardized approach in List-I with their corresponding features in List-II.
- List I: (Elements)
- Business Indicator (BI)
 - Business Indicator Component (BIC)
 - Internal Loss Multiplier (ILM)
 - Loss identification criteria
- List II: (Features)
- Calculated by multiplying the BI by a set of marginal coefficients.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2011

20. Which of the following most appropriately describes a major “Cultural Issue” acting as a barrier to integrated risk management?
- (A) Frequent evolution of real-time business environments stretching regulatory resources and oversight.
 - (B) The lack of standardized metrics to differentiate between credit risk, liquidity risk, and market risk.
 - (C) The high cost of implementing the Advanced Measurement Approach (AMA).
 - (D) Branches not reporting near-miss events due to fear of being questioned or viewed as incompetent.

May/June 2009

21. Consider the following statements regarding the responsibilities of the Operational Risk Management Committee (ORMC):
- I. Identify the operational risks to which the bank is exposed.
 - II. Formulate policies and procedures for operational risk management.
 - III. Carry out day-to-day execution of comprehensive internal audits.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2016

22. Conceptually, Economic Value-Added (EVA) is generated when:
- (A) The standard return on equity matches or exceeds the current market average.
 - (B) The sum total of all organizational risks is precisely equal to the economic capital.
 - (C) Risk-adjusted return exceeds the cost of the related economic capital employed.
 - (D) The internal loss multiplier is less than one.

May/June 2023

23. Consider the following statements regarding the role of Internal Audit in Operational Risk Management:

- I. The internal audit function should be operationally independent.
- II. The internal audit function should be directly responsible for day-to-day operational risk management to ensure tight control.

Which of the above statement(s) is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

Oct/Nov 2005

24. Read the following statements and select the correct answer based on the given Assertion (A) and Reason (R):

Assertion (A): The RAROC approach is an important factor in making risk transfer decisions, such as purchasing insurance.

Reason (R): The benefit of potential risk transfer strategies can be evaluated by comparing the potential decrease in economic capital and risk of loss against the cost of insuring and hedging the position.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2016

25. Consider the following statements regarding Risk Monitoring and Control Practices:

- I. Regular monitoring and feedback mechanisms must be in place to monitor any deterioration in the operational risk profile.
- II. Incident reporting data collation is used exclusively to determine expected profits rather than the frequency and probability of operational risk events.

Which of the above statement(s) is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

CHAPTER 16

Operational Risk and Integrated Risk Management

May/June 2018

1. Consider the following objectives that a well-implemented loss data management framework enables banks to achieve:
- I. Create several scenarios to internally assess adverse business impacts caused by operational failures.
 - II. Conduct suitable contingency planning.
 - III. Gauge the adverse business impact of external events like natural disasters, terrorism, and system failures.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2022

2. Alpha Bank computes its total operational risk capital charge under the AMA model to be ₹1,500 crore. The bank holds a comprehensive operational risk insurance policy. Assuming full compliance with guidelines, what is the maximum regulatory capital allowance it can claim through this insurance mitigation?
- (A) ₹150 crore
 - (B) ₹200 crore
 - (C) ₹300 crore
 - (D) ₹450 crore

May/June 2005

3. What is the primary motivation for the proper management of operational risks in modern banking?
- (A) To secure lesser risk capital requirements and achieve cost reductions in operations.
 - (B) To completely eliminate the probability of occurrence of low-frequency high-severity loss events.
 - (C) To immediately transition from the Basic Indicator Approach to the Advanced Measurement Approach.

- (D) To ensure that external rating agencies assign a favorable risk management rating to the bank.

Oct/Nov 2014

4. Which of the following most appropriately describes the primary function of the operational risk data exchange (e.g., CORDEX India)?
- (A) To provide scenario analysis stress-testing models directly to the regulator.
 - (B) To act as an internal audit consortium for monitoring operational control weaknesses.
 - (C) To serve as a specialized insurance provider covering up to 20% of capital charges.
 - (D) To collect external loss data from banks to aid in migration to advanced approaches.

May/June 2025

5. Consider the following statements regarding the general nature of operational risk:
- I. Operational risk exists almost everywhere in the organisation.
 - II. Operational risks in the organisation remain static regardless of changes undertaken in response to market competition.
 - III. Low occurrence high value risks are more dangerous for the bank and may be fatal for the entities.
- Which of the above statement(s) is/are correct?
- (A) Only I and II
 - (B) Only I and III
 - (C) Only II and III
 - (D) I, II, and III

Oct/Nov 2009

6. A bank conducts an exercise focusing on evaluating its exposure to high-severity events by drawing on the knowledge of experienced risk managers and combining this with external data. This specific methodology is referred to as:
- (A) Risk and Control Self-Assessment (RCSA)
 - (B) The Basic Indicator Approach (BIA)

2. Must use losses net of recoveries, including insurance recoveries.
3. A financial-statement-based proxy for operational risk.
4. A scaling factor based on a bank's average historical losses and the BIC.

(A) P-3, Q-1, R-4, S-2
 (B) P-1, Q-3, R-2, S-4
 (C) P-4, Q-2, R-3, S-1
 (D) P-3, Q-4, R-1, S-2

May/June 2012

33. According to standard regulatory timelines for banks to apply for the Standardised Approach (TSA), what was the designated date of application?

(A) April 1, 2010
 (B) September 30, 2010
 (C) April 1, 2017
 (D) December 15, 2021

Oct/Nov 2023

34. Consider the following scenario: Bank Gamma is compiling its critical loss data fields to meet minimum loss data standards. It uncovers four operational loss events during the year: Event A caused a loss of ₹40,000; Event B caused ₹95,000; Event C caused ₹105,000; and Event D caused ₹200,000. Which events must be included in the calculation of average annual losses?

(A) Event D only
 (B) Events B, C, and D
 (C) Events C and D
 (D) All events must be included

May/June 2024

35. Consider the following factors used to calculate the Capital Charge under the Advanced Measurement Approach (AMA):

- I. Internal loss data of the Bank
- II. External loss data of the Banking Industry
- III. Scenario Analysis
- IV. Business environment and Internal Control factors

Which of the above statement(s) is/are correct?

(A) I, II, and III only
 (B) II, III, and IV only
 (C) I, III, and IV only
 (D) I, II, III, and IV

Oct/Nov 2018

36. Consider the following statements regarding the loss identification process under the standardized approach:

- I. Banks should use gross loss amounts strictly without factoring in any recoveries.
- II. Banks should use losses net of recoveries, including insurance recoveries, in the loss data set.

Which of the above statement(s) is/are correct?

(A) Only I is correct
 (B) Only II is correct
 (C) Both I and II are correct
 (D) Neither I nor II is correct

May/June 2020

37. Arrange the following steps involved in Operation Profiling under the Generic Measurement Approach in the correct chronological order:

- I. Formulation of bank's strategy for operational risk management and risk-based audit.
- II. Identification and quantification of operational risks in terms of its components.
- III. Prioritisation of operational risks and identification of risk concentrations.

Which of the following is the correct sequence?

(A) I, II, III
 (B) II, I, III
 (C) II, III, I
 (D) III, II, I

Oct/Nov 2013

38. Read the following statements and select the correct answer based on the given Assertion (A) and Reason (R):

Assertion (A): Regulators may mandate a bank to apply an Internal Loss Multiplier (ILM) greater than one.

Reason (R): This action is taken if the bank lacks high-quality operational risk annual loss data, thereby penalizing the bank by increasing its regulatory capital requirement.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2019

67. Which of the following is incorrect regarding the reporting structure and responsibilities of the Chief Risk Officer (CRO) according to standard regulatory guidelines?
 (A) The CRO should be a business line head with direct responsibility for generating profit.
 (B) Banks should lay down a Board-approved policy clearly defining the role and responsibilities of the CRO.
 (C) The CRO is responsible for controlling and co-ordinating the functions of the Risk Management Department.
 (D) The CRO's position is part of the organisational approach to effective integrated risk management.

May/June 2016

68. When computing Gross Income under the Basic Indicator Approach, which of the following is NOT an excluded item?
 (A) Realised profits/losses from the sale of securities in the banking book.
 (B) Extraordinary or irregular items.
 (C) Income derived from insurance.
 (D) Net non-interest income.

Oct/Nov 2015

69. Under the regulatory standardized approach, banks are required to use loss data as a direct input for operational risk capital calculations if their Business Indicator (BI) range exceeds a specific threshold. What is this threshold?
 (A) ₹5,000 crore
 (B) ₹8,000 crore
 (C) ₹10,000 crore
 (D) ₹100,000

May/June 2010

70. Which of the following statements regarding the Standardised Approach (TSA) Beta Factors is incorrect?
 (A) Corporate finance carries a high risk factor of 18%.
 (B) Retail Banking carries a low risk factor of

12%.

- (C) Commercial Banking carries a moderate risk factor of 18%.
 (D) Payment and Settlement carries a high risk factor of 18%.

Oct/Nov 2025

71. Consider the following core elements involved in determining operational risk capital requirements under the standardized approach:
 I. The business indicator (BI)
 II. Business indicator component (BIC)
 III. Internal loss multiplier (ILM)
 IV. Capital adjustment scaling factor
 V. Minimum loss data standard factor
 Which of the above statement(s) is/are correct?
 (A) I, II, and III
 (B) I, II, and IV
 (C) II, III, and V
 (D) I, III, and V

May/June 2006

72. Under the Standardised Approach (TSA), an institution has an average gross income of ₹500 crore from Corporate Finance and ₹800 crore from Retail Brokerage over the assessment period. What is the total combined capital charge for these two business lines?
 (A) ₹186 crore
 (B) ₹195 crore
 (C) ₹220 crore
 (D) ₹234 crore

Oct/Nov 2010

73. Under the standardized approach for operational risk, what is the minimum threshold for including a loss event in the data collection and calculation of average annual losses?
 (A) ₹50,000
 (B) ₹100,000
 (C) ₹500,000
 (D) ₹1,000,000

May/June 2017

74. Which of the following conceptually explains why the Advanced Measurement Approach (AMA) is considered more suitable for big-sized banks?
 (A) AMA relies heavily on industry-wide gross income indicators that only large banks can effectively aggregate and track.
 (B) AMA is expensive due to automation costs,

require validation through comparison to actual loss experience, as expert opinions are definitive.

Which of the above statement(s) is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

May/June 2005

46. Which of the following is NOT classified as a cause-based category of operational risk?

- (A) People oriented causes
- (B) Process oriented (Transaction based) causes
- (C) Loss of recourse
- (D) Technology oriented causes

Oct/Nov 2009

47. Consider the following components advised for consideration as part of Business Environment and Internal Control Factors (BEICF):

- I. Risk and Control Self-Assessment (RCSA)
- II. Key Risk Indicators (KRI)
- III. Internal Loss Multiplier (ILM)

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2025

48. Identify the incorrect pair regarding effect-based classifications of operational risk.

- (A) Legal liability – Effect-based
- (B) Restitution – Effect-based
- (C) Write-downs – Effect-based
- (D) Obsolete applications – Effect-based

Oct/Nov 2017

49. The treasury department of a bank utilizes workshops and checklists to assess the number of times operational risk events could happen and the subsequent financial impact, specifically aiming to derive a risk profile and identify control gaps. What is this exercise called?

- (A) Key Risk Indicator Measurement
- (B) Risk and Control Self-Assessment (RCSA)
- (C) External Loss Data Scaling
- (D) Scenario Analysis

May/June 2013

50. Which of the following is NOT an event-based classification of operational risk?

- (A) Clients, products and business practices
- (B) Employment practices and workplace safety
- (C) Loss or damage to assets
- (D) Damage to physical assets

Oct/Nov 2006

51. Consider the following examples of indicators in a banking environment:

- I. Inadequate staffing levels leading to poor customer service.
- II. Total realized profits from HTM transactions over three years.
- III. Too many operations found in the Suspense account head of the branches.

Which of the above are examples of Key Risk Indicators (KRIs)?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2021

52. Which of the following describes the definition of the event classification “Execution, Delivery and Process Management”?

- (A) Losses arising from the disruption of business operations or system failures specifically affecting execution systems.
- (B) Losses due to acts intended to circumvent company policy, involving at least one internal party or authorized user.
- (C) Losses arising from an unintentional or negligent failure to meet various professional suitability requirements.
- (D) Losses from failed transaction processing, process management, or relations with trade counterparties and vendors.

Oct/Nov 2024

53. Which of the following best defines Integrated Risk Management?

- (A) Managing solely the operational risks and ignoring liquidity and market risks.
- (B) The mathematical addition of liquidity, interest rate, market, credit, and operational risk to determine absolute loss.
- (C) The process of isolating various risk factors into discrete silos for individual departmental management.
- (D) Coordinated management of all risks across the organisation associated with all undertaken activities.

- 17.** (B) Establishing a strong risk management culture with appropriate standards and incentives for professional behavior.

Establishing a strong risk management culture is a fundamental principle of operational risk governance. This involves setting clear standards for professional behavior and creating incentives that encourage staff to identify and report risks. A robust culture ensures that risk awareness is embedded throughout the organization, making every employee responsible for maintaining the bank's integrity and long-term operational resilience and stability.

- 18.** (C) Presence of stand-alone legacy systems making workflow connectivity impossible.

Business challenges that drive integrated risk management include market evolution, technological change, and the need to enhance shareholder value. While the presence of stand-alone legacy systems is a significant operational hurdle, it is categorized as a technical or structural barrier rather than a broader business challenge. Challenges focus on shifts in the external environment and strategic corporate goals of the institution.

- 19.** (D) I, II, III, and IV

A comprehensive operational risk management policy must cover the management structure, clear roles and responsibilities, and standardized processes. It also requires detailed methodologies for risk assessment and measurement to ensure consistency across the organization. Together, these elements form a robust framework that allows the bank to identify, measure, monitor, and control operational exposures effectively across all business lines.

- 20.** (D) Branches not reporting near-miss events due to fear of being questioned or viewed as incompetent.

A major cultural barrier in risk management is the fear of repercussions, which leads employees to hide near-miss events or minor failures. When staff believe reporting errors will result in punishment or perceived incompetence, the bank loses valuable data for risk mitigation. Overcoming this requires a culture that prioritizes learning and transparency over individual accountability and encourages honest reporting of failures.

- 21.** (A) I and II only

The Operational Risk Management Committee is responsible for identifying the bank's risk exposures and formulating management policies and procedures. However, it does not perform the day-to-day execution of internal audits. Auditing is an independent function that reviews the effectiveness of the framework established by the committee, ensuring a clear separation between management and the oversight of risk controls.

- 22.** (C) Risk-adjusted return exceeds the cost of the related economic capital employed.

Economic Value-Added is a performance metric indicating that a bank is generating returns above its cost of capital. It occurs when the risk-adjusted return on a business activity exceeds the cost of the economic capital required to support that activity. This measure helps management identify which business units and activities are truly profitable after accounting for the specific risks they undertake.

- 23.** (A) Only I is correct

Internal audit must remain operationally independent from the functions it reviews to provide objective assessments of the risk management framework. It should not be responsible for day-to-day operational risk management, as this would create a conflict of interest. The audit's role is to verify that policies are followed and that the controls implemented by management are effective and robust.

- 24.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The Risk-Adjusted Return on Capital approach provides a quantitative framework for evaluating risk transfer decisions like purchasing insurance. By comparing the cost of premiums against the potential reduction in economic capital and expected losses, banks can determine if insuring a specific risk is financially beneficial. This analysis ensures that risk mitigation strategies are aligned with the bank's overall profitability and goals.

- 25.** (A) Only I is correct

Effective risk management requires continuous monitoring and feedback to detect any deterioration in the operational risk profile.

May/June 2014

60. Which of the following statements regarding the processes and framework for Operational Risk is incorrect?
- (A) Key business processes in the bank must be mapped into sub-processes to identify specific control weaknesses.
 - (B) A scorecard approach should be implemented to qualitatively analyse the operational risk profile.
 - (C) Mapping of processes should be an exclusive exercise undertaken solely by the operational risk group.
 - (D) Implementation of a quantitative approach to assessing operational risks in new product processes is included.

Oct/Nov 2011

61. A large commercial bank finds that its retail branch managers routinely hide minor operational losses from the central loss database to maintain unblemished performance records. In the context of Integrated Risk Management challenges, what specific type of barrier does this highlight?
- (A) Real-Time Concern
 - (B) Cultural Issue
 - (C) Systemic Regulatory Challenge
 - (D) External Data Constraint

May/June 2019

62. Identify the incorrect pair regarding the organizational structure of Operational Risk Management.
- (A) Board of Directors – Puts in place a comprehensive internal audit system to monitor the ORM framework's efficacy.
 - (B) ORM Committee – Ensures the adequacy of risk mitigating controls and monitors the overall risk profile.
 - (C) ORM Department – Responsible for managing and implementing the operational risk framework at the apex level.
 - (D) Internal Audit – Assesses the effectiveness of the ORM framework operationally independently.

Oct/Nov 2016

63. A financial institution compares two business units. Unit A has a higher net income than Unit B. However, Unit A takes on significantly greater risk to achieve those returns. To make

an accurate profitability and pricing decision factoring in the economic capital utilized, which metric should management apply?

- (A) Basic Indicator Approach (BIA) Alpha ratio
- (B) Key Risk Indicator (KRI) frequency
- (C) Internal Loss Multiplier (ILM)
- (D) Risk-Adjusted Rate of Capital (RAROC)

May/June 2009

64. Consider the following scenario: A commercial bank plans to launch a complex digital lending product. The Operational Risk Management Department assesses the inherent risks. Before the product is implemented at the branch level, whose approval must be obtained based on standardized organizational structure guidelines?
- (A) Chief Risk Officer
 - (B) Board of Directors
 - (C) Internal Audit Head
 - (D) Operational Risk Management Committee (ORMC)

Oct/Nov 2005

65. Identify the correct pair regarding the components of the Integrated Risk Management Approach.
- (A) Strategy – Separation of credit risk management function from the credit sanction process.
 - (B) Systems – Providing information and analytical tools to support the Enterprise Risk Management functions.
 - (C) Process – Establishing the Chief Risk Officer's position.
 - (D) Organisation – Integration of risk management as a key corporate strategy.

May/June 2023

66. Identify the correct option after evaluating the following Assertion (A) and Reason (R):
Assertion (A): Operational risk quantification is considered the most difficult of all risk measurements.
Reason (R): The behaviour pattern of operational risk does not follow the statistically normal distribution pattern, making the probability estimation of an event resulting in losses difficult.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

ANSWERS

NODIA

1. (D) I, II, and III

A robust loss data management framework provides a historical foundation for banks to model future operational risks effectively. By tracking internal failures, banks can create realistic scenarios to assess potential business impacts and strengthen their resiliency through informed contingency planning. This framework also allows institutions to quantify the adverse effects of unpredictable external events like terrorism or natural disasters.

2. (C) ₹300 crore

Under the Advanced Measurement Approach, banks are permitted to use insurance as a mitigator to reduce their total operational risk capital charge. However, regulatory guidelines strictly cap this allowance at twenty percent of the total charge. For a capital requirement of fifteen hundred crore, twenty percent equals three hundred crore, which represents the maximum claimable regulatory capital allowance.

3. (A) To secure lesser risk capital requirements and achieve cost reductions in operations.

The primary motivation for managing operational risk in modern banking is to optimize the amount of risk capital required by regulators. Effective management directly leads to significant cost reductions in daily operations and improves overall financial efficiency. By reducing capital requirements, banks can utilize their resources more effectively while protecting themselves against unexpected losses and enhancing shareholder value.

4. (D) To collect external loss data from banks to aid in migration to advanced approaches.

Operational risk data exchanges like CORDEX India facilitate the sharing of external loss data among participating banking institutions. This collaborative effort is crucial for banks transitioning to advanced measurement approaches, as internal data alone often lacks the volume needed for robust risk modeling. Shared data help banks better understand industry-wide

risk profiles and improve the accuracy of risk quantification.

5. (B) Only I and III

Operational risk is pervasive, existing in every department and function across a banking organization. While many risks occur frequently with minor impact, low-occurrence high-value events are the most dangerous and can be fatal to an entity's survival. These risks are dynamic rather than static, evolving constantly as market competition and technological advancements change the bank's operating environment.

6. (C) Scenario Analysis

Scenario analysis is a forward-looking risk assessment methodology that draws on the specialized knowledge of experienced risk managers and historical external data. It focuses on evaluating a bank's exposure to high-severity, low-probability events that internal loss history might not capture. This qualitative approach helps identify potential vulnerabilities and assesses the adequacy of the bank's current contingency and resilience plans.

7. (A) P-2, Q-3, R-4, S-1

Operational risks are categorized by cause to improve mitigation strategies across the organization. People-oriented causes involve human factors like negligence or incompetence, while process-oriented risks are divided into transaction-based issues, such as product complexity, and control-based failures, like inadequate supervision. External causes encompass uncontrollable events like natural disasters or political instability that significantly impact the bank's daily operations.

8. (A) II, I, III

The Risk and Control Self-Assessment process begins by identifying gaps between existing risks and the effectiveness of current controls. Following this, frequency and severity values are utilized to generate a comprehensive risk profile for the specific business unit. Finally, management develops an action plan or preventive measures

advanced model development, and an independent risk function.

- (C) AMA requires mitigating insurance policies up to 100%, which only large-sized banks can afford to maintain annually.
- (D) AMA exclusively utilizes external rating agency scores that are typically only available to large banking conglomerates.

Oct/Nov 2023

75. Which of the following statements regarding the Internal Loss Multiplier (ILM) under the standardized approach is incorrect?

- (A) The ILM is a scaling factor based on historical losses and the BIC.
- (B) Regulators may require banks to apply an ILM greater than one if they do not have high-quality operational risk annual loss data.
- (C) The exclusion of internal loss data due to non-compliance must be made publicly available as part of disclosure requirements.
- (D) Applying an ILM greater than one decreases the regulatory capital requirement for operational risk.

May/June 2012

76. Consider the following pre-conditions required for a bank to migrate to the Advanced Measurement Approach (AMA):

- I. Risk measurement has to be integrated into day-to-day risk management functions.
- II. Risk mitigation like insurance is restricted to only 20% of the exposure.
- III. The risk measurement process must be periodically reviewed by internal/external audit.
- IV. To start, a maximum of five-year loss data across 7 loss types is required.
- V. A minimum of seven years of data is required over a period of time.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, III, IV, and V

Oct/Nov 2018

77. Which of the following is a correct statement regarding Scenario Analysis under modern standardized approach guidelines?

- (A) Conducting scenario analysis based

exclusively on internal historical data without external references.

- (B) Using scenario analysis with expert opinion and external data to evaluate high-severity events.
- (C) Implementing scenario analysis as a process that is no longer required under global frameworks.
- (D) It is utilized solely to lower the Internal Loss Multiplier (ILM) below one.

May/June 2024

78. Identify the correct pair representing the scale used to map the Estimated Probability of Occurrence.

- (A) 2 – Medium risk
- (B) 5 – Medium risk
- (C) 4 – High risk
- (D) 1 – High risk

Oct/Nov 2013

79. A scheduled commercial bank is migrating to a new standardized approach but its historical loss tracking mechanism is flawed. Consequently, the bank fails to meet the required 5-years-loss data standards. How will its operational risk capital requirement be determined?

- (A) It will be required to apply a 15% flat rate to its gross income regardless of the BIC.
- (B) It will be completely exempted from capital charges until the data reaches a 5-year maturity.
- (C) It will be mandated to use solely external loss data from industry consortiums.
- (D) It will be required to hold capital at least equal to 100% of the Business Indicator Component (BIC).

May/June 2020

80. In a generic measurement approach, the probability of occurrence is assessed at 3, the potential financial impact is 5, and the impact of internal controls is evaluated at 40%. Using the formula for the estimated level of operational risk $\{[(\text{Probability} \times \text{Impact} \times (1 - \text{Internal Controls}))^{0.5}]\}$, what is the resulting value?

- (A) 2.50
- (B) 3.00
- (C) 3.50
- (D) 4.00

May/June 2011

54. Consider the following scenario: A regional cooperative bank's headquarters suffered severe structural damage due to an unpredicted earthquake, leading to destruction of hardware and data centers. Under which operational risk event type should this loss be classified?
- (A) Business disruption and system failures
(B) Execution, delivery and process management
(C) Damage to physical assets
(D) External Fraud

Oct/Nov 2012

55. Read the following statements and select the correct answer based on the given Assertion (A) and Reason (R):
- Assertion (A): Integrated risk management goes beyond merely strategizing for surplus; it focuses on aggregate risk levels to optimize capital utilization.
- Reason (R): Risks add to instability, requiring capital that is commensurate with the expected worst-case scenarios, making risk-adjusted return on capital critical.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2007

56. Which of the following statements correctly identifies a core principle for the sound management of operational risk?
- (A) The board of directors should take the lead in establishing a strong risk management culture.
(B) Senior management should approve the bank's operational risk management framework and review it periodically.
(C) The board of directors should develop for approval by senior management a clear, effective and robust governance structure.
(D) The operational risk management department is responsible for approving a risk appetite and tolerance statement.

Oct/Nov 2008

57. When properly implemented, Integrated Risk Management achieves all of the following objectives EXCEPT:
- (A) Completely eliminates all earnings volatility and downside risk potential.
(B) Aligns the strategic aspects of risk with day-to-day operational activities.
(C) Facilitates greater transparency for investors and regulators.
(D) Enhances revenue and earnings growth.

May/June 2022

58. Match the Governance and Risk Management Environment Principles in List-I with their focus areas in List-II.
- List I: (Principles)
- P. Principle 3
Q. Principle 5
R. Principle 7
S. Principle 10
- List II: (Focus Areas)
1. Business resiliency and continuity plans
 2. Approval process for all new products assessing operational risk
 3. Board of directors establishing, approving and periodically reviewing the Framework
 4. Senior management developing a clear, effective and robust governance structure
- (A) P-4, Q-3, R-1, S-2
(B) P-3, Q-4, R-2, S-1
(C) P-2, Q-1, R-3, S-4
(D) P-3, Q-4, R-1, S-2

Oct/Nov 2020

59. Consider the following "Business Challenges" providing impetus for effective risk management:
- I. Developing global marketplace
 - II. Concern about business continuity and operational reliability
 - III. Continuous and accelerating technological change
 - IV. Limiting earnings' volatility and enhancing shareholder value
 - V. The establishment of risk management ratings by agencies
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V
(B) I, II, IV, and V
(C) I, II, III, and IV
(D) II, III, IV, and V

to address the identified weaknesses and improve the overall control environment.

9. (D) I, II, III, IV, and V

The Basel framework identifies seven distinct categories of operational risk events to ensure comprehensive tracking. These categories include internal and external fraud, damage to physical assets, and business disruption caused by system failures. Additionally, banks must monitor execution, delivery, and process management failures, as well as employment practices and workplace safety, to maintain a complete view of organizational risk.

10. (B) A variable that provides a reliable basis for estimating the loss corresponding to a risk.

Key Risk Indicators are predictive variables used by banks to monitor operational risk profiles over time. They provide a reliable basis for estimating potential losses by tracking changes in the risk environment and internal processes. Unlike retroactive audits, KRIs act as early warning signals, allowing management to take proactive steps when risk levels exceed predefined thresholds to prevent major failures.

11. (A) Losses from acts inconsistent with employment or safety laws, personal injury claims, or diversity/discrimination events.

The event classification for employment practices and workplace safety focuses on losses arising from acts inconsistent with labor, health, or safety laws. This includes personal injury claims, workers' compensation issues, and events related to diversity or discrimination. Managing this risk ensures compliance with regulations and protects the bank from legal liabilities and reputational damage stemming from the workplace.

12. (C) Key Risk Indicator (KRI)

A sudden spike in customer complaints serves as a vital Key Risk Indicator for operational quality. It acts as a forward-looking metric signaling potential business loss and service failures. By monitoring these indicators, management can identify deteriorating trends in process execution or staff performance before they manifest as significant financial losses or lead to large-scale customer attrition in the bank.

13. (A) P-4, Q-3, R-1, S-2

Internal fraud involves losses from intentional acts by employees to defraud the bank, while external fraud refers to similar acts committed by third parties. The category for clients, products, and business practices covers unintentional failures to meet professional obligations to specific clients. Business disruption and system failures specifically address losses resulting from operational halts or hardware and software problems.

14. (C) Because of diversification effects for similar risks and the interplay between various types of risk.

The total risk of an organization is not a simple sum of individual risks due to diversification effects. Similar risks often offset each other, while different risk types may have complex interplays that impact the overall profile. This integration means that the aggregate risk requirement depends on how various factors correlate, potentially resulting in a lower total than individual parts.

15. (D) Execution, delivery and process management
Losses caused by transaction processing failures, such as wiring funds to the wrong vendor due to data entry errors, fall under execution, delivery, and process management. This category addresses risks associated with daily operational flow, including errors in documentation, collateral management, and maintaining relationships with trade counterparties. It focuses on the breakdown of standardized steps required to complete business transactions.

16. (C) I, II, and IV only

Integrated risk management aligns strategic goals with daily operations and increases transparency for investors and regulators. While it enhances revenue growth and earnings stability by optimizing capital use, it cannot guarantee the complete elimination of downside risk. No framework can remove all risk; instead, it aims to manage and mitigate exposures to acceptable levels defined by the bank's risk appetite.

May/June 2008

39. Consider the following parameters used to estimate the level of operational risk under a generic measurement approach:

- I. Estimated probability of occurrence
 - II. Gross income across eight business lines
 - III. Estimated potential financial impact
 - IV. Beta factors assigned to internal fraud
 - V. Estimated impact of internal controls
- Which of the above statement(s) is/are correct?

- (A) I, III, and V
- (B) I, II, and III
- (C) III, IV, and V
- (D) I, III, and IV

Oct/Nov 2007

40. Consider the following statements regarding the management and review of minimum loss data standards:

- I. National supervisors should review the quality of banks' loss data periodically.
- II. Banks must have processes to independently review the comprehensiveness and accuracy of loss data.

Which of the above statement(s) is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

Oct/Nov 2021

41. Under the Advanced Measurement Approach (AMA), a bank is permitted to recognise the risk-mitigating impact of insurance. What is the maximum limit of insurance mitigation allowed against the total operational risk capital charge?

- (A) 15%
- (B) 20%
- (C) 25%
- (D) 30%

May/June 2015

42. Which of the following defines 'Operational Risk'?

- (A) The risk of loss resulting from external market fluctuations, credit defaults, and internal technology failures.
- (B) The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
- (C) The risk of loss due to deviations from planned revenues caused by diversification

effects in similar risks.

- (D) The risk of loss resulting from strategic misalignments, compliance failures, and the inability to manage large exposures.

Oct/Nov 2022

43. Read the following statements and select the correct answer based on the given Assertion (A) and Reason (R):

Assertion (A): Under AMA, banks are required to collect external loss data and use them for their capital calculation after applying an appropriate scaling methodology.

Reason (R): Scaling is necessary because data collected from external sources must be adapted to model high severity events, especially for newly started banks or new business lines lacking sufficient internal data.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2018

44. Which of the following most appropriately describes the core reason operational risk has become increasingly critical in the recent banking context?

- (A) Traditional banking systems are inherently flawed and necessitate continuous regulatory oversight and review.
- (B) The rise in global interest rates has necessitated significantly higher capital allocations for operational failures.
- (C) Fast-changing environments and technological advances leave insufficient time to stabilize new systems.
- (D) Bank employees currently receive less rigorous training and mentorship compared to several decades ago.

Oct/Nov 2014

45. Consider the following statements regarding Scenario Analysis in risk management:

- I. Scenario analysis should evaluate potential losses arising from multiple simultaneous operational risk loss events.
- II. Over time, scenario assessments do not

Incident reporting and data collation are primarily used to determine the frequency and probability of risk events, not just expected profits. This data allows the bank to adjust its controls and capital allocations in response to changing risk levels and the occurrence of events.

26. (D) I, II, III, and IV

Regulatory guidelines require banks to appoint a Chief Risk Officer with a clearly defined Board-approved role and responsibilities. The CRO must coordinate all risk management functions and report directly to the MD or CEO to ensure high-level visibility and authority. This structure guarantees that risk management remains a priority and is independent from business lines that might prioritize short-term profit.

27. (A) Figures for years with negative or zero annual gross income should be excluded from the numerator and denominator.

Under the Basic Indicator Approach, the capital charge is calculated using only years with positive annual gross income. Any year where gross income is negative or zero must be excluded from both the numerator and the denominator of the average. This prevents skewed results and ensures the capital requirement is based on periods of active and positive business generation for the bank.

28. (C) The MD or CEO of the Bank

To maintain operational independence and organizational importance, the Chief Risk Officer must report directly to the Managing Director or Chief Executive Officer. This reporting line prevents the risk function from being subordinated to business units or other administrative departments. It ensures that risk considerations are heard at the highest levels of executive management and effectively integrated into strategy.

29. (C) ₹680 crore

Gross Income for the Basic Indicator Approach is calculated by adding operating profit and total provisions, then adjusting for specific exclusions. Starting with six hundred crore profit and adding one hundred fifty crore expenses gives seven hundred fifty crore. Subtracting fifty crore from HTM profits and twenty crore from irregular

income results in a final gross income of six hundred eighty crore.

30. (C) Private Sector Scheduled Commercial Banks
Revised directions for the standardized approach for operational risk apply to most major banking institutions, including Private Sector Scheduled Commercial Banks. Certain specialized or smaller entities, such as Local Area Banks, Payments Banks, and Regional Rural Banks, are often excluded from these specific requirements. Private sector banks must adhere to these standards to ensure robust capital adequacy across the banking industry.

31. (A) P-3, Q-1, R-2, S-2

Under the Standardised Approach, different business lines are assigned specific beta factors based on their perceived risk levels. Trading and Sales is assigned eighteen percent, while Asset Management and Agency Services carry factors of twelve percent and fifteen percent, respectively. Commercial Banking is assigned fifteen percent, reflecting its moderate operational risk profile compared to more complex investment banking and trading activities.

32. (A) P-3, Q-1, R-4, S-2

The Business Indicator is a financial proxy for operational risk, which is multiplied by coefficients to determine the Business Indicator Component. The Internal Loss Multiplier then scales this component based on the bank's actual historical loss experience. Loss identification requires using amounts net of all recoveries, including insurance, to provide an accurate picture of the final financial impact on the organization.

33. (A) April 1, 2010

April first, two thousand ten, was the designated date from which banks in India could apply to the Reserve Bank for permission to migrate to the Standardised Approach for operational risk. This timeline was part of the phased implementation of Basel II norms, allowing banks to move from the Basic Indicator Approach to more risk-sensitive and sophisticated capital calculation methodologies.

Oct/Nov 2022

13. Match the entities in List I with their respective responsibilities in List II regarding the Governance of Liquidity Risk Management:

List I: Entities

- P. Board of Directors (BoD)
- Q. Risk Management Committee
- R. Asset-Liability Management Committee (ALCO)
- S. ALM Support Group

List II: Responsibilities

- 1. Analyzing, monitoring and reporting the liquidity risk profile
 - 2. Overall responsibility for management of liquidity risk
 - 3. Implementing the liquidity risk management strategy
 - 4. Evaluating the overall risks faced by the bank including liquidity risk
- (A) P-2, Q-4, R-3, S-1
 - (B) P-4, Q-2, R-1, S-3
 - (C) P-2, Q-1, R-4, S-3
 - (D) P-3, Q-4, R-2, S-1

May/June 2008

14. Identify the incorrect statement regarding the measurement and management of liquidity risk as per BCBS Principles.
- (A) A bank should have a robust framework for comprehensively projecting cash flows over an appropriate set of time horizons.
 - (B) A bank should actively monitor funding needs across legal entities, business lines, and currencies.
 - (C) A bank should establish a funding strategy that relies exclusively on a single highly liquid market to minimize diversification costs.
 - (D) A bank should regularly gauge its capacity to raise funds quickly from each source.

Oct/Nov 2011

15. Match the Liquidity Ratios in List I with their corresponding significance in List II:

List I: Liquidity Ratios

- P. Core deposits/Total Assets
- Q. Temporary Assets/Total Assets
- R. Temporary Assets/Volatile Liabilities
- S. Volatile Liabilities/Total Assets

List II: Significance

- 1. Measures the extent to which assets are funded through stable deposit base.

- 2. Measures the extent of available liquid assets.
 - 3. Measures the cover of liquid investments relative to volatile liabilities.
 - 4. Measures the extent to which volatile liabilities fund the balance sheet.
- (A) P-1, Q-2, R-3, S-4
 - (B) P-2, Q-1, R-4, S-3
 - (C) P-3, Q-4, R-1, S-2
 - (D) P-4, Q-3, R-2, S-1

May/June 2020

16. Which of the following best explains why banks are referred to as 'Maturity Transformation Agents'?
- (A) They accept deposits with shorter tenors and provide advances for longer periods.
 - (B) They ensure perfectly matched portfolios to eliminate market risks completely.
 - (C) They match long-term deposits with short-term advances to generate continuous cash flows.
 - (D) They rely exclusively on equity funds to finance long-term infrastructural loans.

Oct/Nov 2006

17. Consider the following statements regarding the management of liquidity risk:
- I. A bank should define and identify the liquidity risk to which it is exposed for each major on and off-balance sheet position.
 - II. The flow approach measures liquidity by calculating certain ratios and comparing them to established benchmarks.
 - III. The stock approach forecasts liquidity at different points of time by tracking cash flow mismatches over time periods.
 - IV. Bank management should concentrate more on time buckets which reveal negative gaps.
 - V. Any futuristic approach fits adequately within the risk management framework very well.

Which of the above statements represents the correct concepts?

- (A) I, II, and III only
- (B) I, IV, and V only
- (C) II, III, and IV only
- (D) I, III, IV, and V only

and natural disasters that disrupt the bank's normal business operations.

43. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Under the Advanced Measurement Approach, external loss data is vital for modeling rare but high-severity events that may not exist in a bank's internal history. However, this data must be scaled to fit the bank's specific size and risk profile. Scaling ensures that industry-wide data is relevant and proportional, providing a more accurate estimation of potential tail risks for the institution.

44. (C) Fast-changing environments and technological advances leave insufficient time to stabilize new systems.

The increasing importance of operational risk is driven by the rapid pace of technological change and the fast-evolving business environment. Constant innovation often means banks implement new systems and processes without having sufficient time to stabilize them or fully understand their long-term vulnerabilities. This speed increases the likelihood of system failures and process errors, making operational risk management more critical than ever.

45. (A) Only I is correct

Scenario analysis is designed to evaluate potential losses from multiple simultaneous operational failures, reflecting complex real-world crises. Unlike historical data, it captures hypothetical combinations of events. These assessments must be periodically validated against actual loss experiences to ensure that expert opinions remain realistic and that the underlying assumptions of the models are still sound and relevant for the bank's current profile.

46. (C) Loss of recourse

Operational risks are classified by causes like people, processes, and technology to help banks target their mitigation efforts effectively. While "Loss of recourse" describes a specific type of financial effect or outcome resulting from an operational failure, it is not a root cause itself. Categorizing by cause allows management to identify whether failures stem from human error, system glitches, or procedural weaknesses.

47. (A) I and II only

Business Environment and Internal Control Factors involve forward-looking assessments like Risk and Control Self-Assessments and Key Risk Indicators. These factors provide a qualitative view of the bank's risk profile and control environment. The Internal Loss Multiplier, however, is a quantitative scaling factor used in the standardized approach based on historical losses, rather than a component of the internal assessment.

48. (D) Obsolete applications – Effect-based

Effect-based classifications focus on the financial outcome of an operational event, such as legal liabilities, restitution payments, or asset write-downs. Obsolete applications represent a technological cause or a state of the infrastructure rather than the financial effect itself. Proper classification helps banks understand the direct impact of operational failures on their balance sheets and profit and loss statements.

49. (B) Risk and Control Self-Assessment (RCSA)
Risk and Control Self-Assessment utilizes workshops and checklists where business units evaluate their own risks and the effectiveness of their controls. The goal is to estimate the frequency and impact of potential events to create a risk profile and identify where controls are lacking. This self-assessment fosters a stronger risk culture by involving staff directly in the management and mitigation process.

50. (C) Loss or damage to assets

Event-based classifications include "Damage to physical assets," "External Fraud," and "Employment practices and workplace safety." The term "Loss or damage to assets" is too broad and often used as a general description of effect. The Basel framework uses specific categories like "Clients, products and business practices" to ensure that every operational risk event is recorded under a well-defined heading.

51. (C) I and III only

Key Risk Indicators are metrics that signal changes in risk exposure. Inadequate staffing levels and excessive operations in suspense accounts are classic KRIs because they indicate potential process failures or control weaknesses. Realized profits from transactions are historical

CHAPTER 17

Liquidity Risk Management

Oct/Nov 2012

1. Which of the following pairs correctly matches the potential liquidity risk driver with its appropriate category?
(A) Low/slow economic performances — Internal Banking Factor
(B) Less allocation in liquid government instruments — External Banking Factor
(C) Decreasing depositors' trust on the banking sector — Internal Banking Factor
(D) High off-balance sheet exposures — Internal Banking Factor

May/June 2021

2. The Board of Directors (BoD) has the overall responsibility for the management of liquidity risk. All of the following are specific responsibilities of the BoD in this regard, EXCEPT:
(A) Deciding the strategy, policies, and procedures to manage liquidity risk.
(B) Ensuring it understands the nature of the liquidity risk across all branches.
(C) Preparing forecasts and simulations regarding changes in market conditions.
(D) Formulating and reviewing the contingency funding plan and related assets.

Oct/Nov 2007

3. Liquidity risk typically manifests in the short term, which is why it is often referred to by banks as:
(A) 'Terminal' risk
(B) 'Contagion' risk
(C) 'ICU' risk
(D) 'Solvency' risk

May/June 2014

4. Read the following statements and select the correct option:
Assertion (A): The flow approach to measuring liquidity is considered superior to the stock approach.
Reason (R): The flow approach is an indicator of past action, capturing past data to arrive at

ratios, whereas the stock approach forecasts liquidity at different points of time in the future.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2023

5. Consider the following statements regarding the BCBS Fundamental principles for liquidity risk management:
 - I. A bank should establish a robust framework that maintains a cushion of unencumbered, high-quality liquid assets.
 - II. A bank should clearly articulate a liquidity risk tolerance appropriate for its business strategy.
 - III. The board of directors is exclusively responsible for developing strategies, policies, and practices on a daily basis.Which of the above statements is/are correct?
(A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

May/June 2005

6. Match the Ratios in List I with their respective Industry Averages in List II:
List I: Ratios
P. Temporary Assets/Total Assets
Q. Core deposits/Total Assets
R. Temporary Assets/Volatile Liabilities
S. (Loans + mandatory SLR + mandatory CRR + Fixed Assets)/Total Assets
List II: Industry Averages
1. 80%
2. 40%
3. 50%
4. 60%

- 60.** (C) Mapping of processes should be an exclusive exercise undertaken solely by the operational risk group.

Mapping key business processes into sub-processes is essential for identifying specific control weaknesses. However, this should not be an exercise exclusive to the operational risk group. It requires the active participation of business line managers and staff who understand the daily workflow. Collaborative mapping ensures that the identified risks and controls are realistic and reflect the actual operations of the bank.

- 61.** (B) Cultural Issue

Hiding operational losses to protect performance records is a classic cultural barrier in risk management. This behavior stems from an environment where employees fear the consequences of reporting mistakes. Such a culture prevents the bank from accurately measuring its risk exposure and implementing necessary controls, highlighting the need for a management approach that encourages transparency, honesty, and proactive reporting of failures.

- 62.** (C) ORM Department – Responsible for managing and implementing the operational risk framework at the apex level.

The Operational Risk Management Committee (ORMC) is typically responsible for managing and implementing the framework at the apex level, not the department alone. The department usually handles the technical and administrative aspects of the framework, while the committee provides the strategic oversight and authority needed for bank-wide implementation and ensures that risk-mitigating controls are adequate and effective.

- 63.** (D) Risk-Adjusted Rate of Capital (RAROC)

To compare business units with different risk profiles, management uses the Risk-Adjusted Return on Capital. RAROC adjusts net income for the specific risks taken, allowing for a fair comparison of profitability relative to the economic capital used. This metric is crucial for making informed decisions about product pricing and determining which business activities are truly adding value to the bank.

- 64.** (D) Operational Risk Management Committee (ORMC)

Standardized governance guidelines require that any new product or complex activity undergoes a rigorous operational risk assessment. This assessment must be reviewed and approved by the Operational Risk Management Committee before the product is launched. This ensures that potential risks are identified and mitigated at a high level, preventing operational failures once the product becomes active at the branch level.

- 65.** (B) Systems – Providing information and analytical tools to support the Enterprise Risk Management functions.

In an integrated risk management approach, the systems component refers to the technological infrastructure that provides information and analytical tools. These systems support the entire Enterprise Risk Management function by allowing for efficient data collection, risk measurement, and reporting. Effective systems are necessary to turn raw data into actionable insights for management to monitor and control various risks across the organization.

- 66.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Quantifying operational risk is uniquely difficult because it does not follow a statistically normal distribution. Losses are often characterized by high-frequency small events and rare but catastrophic large events, resulting in fat-tailed distributions. This lack of predictability makes it challenging for banks to estimate the probability and severity of future losses compared to the modeling used for market or credit risks.

- 67.** (A) The CRO should be a business line head with direct responsibility for generating profit.

The Chief Risk Officer must be independent from profit-generating business lines to avoid conflicts of interest. Regulatory guidelines emphasize that the CRO should not have direct responsibility for business operations or profit targets. Instead, they focus on coordinating the risk management department and ensuring board-approved policies are followed throughout the organization, providing a neutral assessment of the bank's risk exposure.

68. (D) Net non-interest income

When calculating Gross Income for the Basic Indicator Approach, net non-interest income is included as a core part of the bank's earning capacity. Exclusions are specifically reserved for items like realized profits from the banking book, extraordinary or irregular income, and income from insurance. These exclusions ensure the capital charge is based on stable, recurring revenue from core banking activities.

69. (B) ₹8,000 crore

Under the modern standardized approach, banks with a Business Indicator exceeding eight thousand crore rupees are generally required to use their internal loss data as a direct input for capital calculations. This threshold ensures that larger, more complex institutions, which have a greater impact on financial stability, use more sensitive and accurate methods to determine their operational risk capital requirements.

70. (C) Commercial Banking carries a moderate risk factor of 18%.

Under the Standardised Approach, Commercial Banking is assigned a beta factor of fifteen percent, not eighteen percent. Trading and Sales and Corporate Finance are the lines typically assigned the highest factor of eighteen percent. Retail Banking carries the lowest at twelve percent. These factors reflect the varying levels of operational complexity and inherent risk associated with different banking business lines.

71. (A) I, II, and III

The three core elements for determining operational risk capital under the current standardized approach are the Business Indicator, the Business Indicator Component, and the Internal Loss Multiplier. The BI serves as the financial proxy, the BIC is the base charge calculated from the BI, and the ILM is the scaling factor that adjusts the charge based on the bank's specific loss history.

72. (A) ₹186 crore

To calculate the capital charge under the Standardised Approach, you multiply the gross income of each business line by its assigned beta factor. Corporate Finance results in ninety crore, while Retail Brokerage results in ninety-six crore. Adding these together gives a total combined

capital charge of one hundred eighty-six crore for these two business lines, reflecting their relative risk weights and income.

73. (B) ₹100,000

For the purposes of collecting loss data and calculating average annual losses under the standardized approach, the minimum threshold is set at one hundred thousand rupees. Any operational loss event smaller than this amount is not required to be included in the specific data set used for regulatory capital calculations, although banks should still track them for internal risk management purposes.

74. (B) AMA is expensive due to automation costs, advanced model development, and an independent risk function.

The Advanced Measurement Approach is better suited for large banks because of its high implementation costs. It requires sophisticated automated systems, the development of complex mathematical models, and the maintenance of an entirely independent risk management function. Smaller banks often lack the scale and financial resources to invest in these advanced requirements, making simpler approaches more practical for their operational needs.

75. (D) Applying an ILM greater than one decreases the regulatory capital requirement for operational risk.

Applying an Internal Loss Multiplier greater than one actually increases the regulatory capital requirement for operational risk. This occurs when a bank's historical losses are high relative to its Business Indicator Component or when its data quality is poor. The ILM acts as a risk-sensitive adjustment that penalizes institutions with higher-than-average operational failures or inadequate risk reporting systems and standards.

76. (D) I, II, III, IV, and V

Banks migrating to AMA must integrate risk measurement into daily functions and undergo regular audit reviews. Initially, five years of loss data across seven types is required, with a target of seven years over time. Additionally, any capital relief from risk mitigators like insurance is strictly capped at twenty percent of the total operational risk capital charge for the bank.

77. (B) Using scenario analysis with expert opinion and external data to evaluate high-severity events. Modern risk management frameworks emphasize the use of scenario analysis as a qualitative tool. By combining expert opinions with external loss data, banks can evaluate their vulnerability to high-severity events that are not present in their internal records. This process is essential for understanding tail risks and ensuring that the bank remains resilient during extreme operational failures or industry-wide crises.

78. (C) 4 – High risk
In generic risk measurement models, the estimated probability of occurrence is often mapped to a numerical scale for assessment. A score of four is typically used to represent a high-risk level, indicating that the event is likely to occur frequently. This mapping allows banks to prioritize their focus on risks that are most likely to manifest and cause operational disruptions.

79. (D) It will be required to hold capital at least equal to 100% of the Business Indicator Component (BIC).
If a bank fails to meet the minimum five-year loss data standards required by the standardized approach, it faces a regulatory penalty. In such cases, the bank is generally mandated to hold capital at least equal to one hundred percent of its Business Indicator Component. This ensures a conservative capital buffer is maintained when the bank's internal loss history is insufficient or unreliable.

80. (B) 3.00
To calculate the level of operational risk, multiply the probability of three by the impact of five, which equals fifteen. Adjust for the forty percent internal control effectiveness by multiplying fifteen by zero point six, resulting in nine. Taking the square root of nine yields a final estimated level of operational risk of three point zero zero for the specific assessment.

NODIA

financial performance metrics and do not serve as forward-looking indicators of operational risk levels or deteriorating internal controls within the bank environment.

- 52.** (D) Losses from failed transaction processing, process management, or relations with trade counterparties and vendors.
Execution, delivery, and process management losses stem from failures in transaction processing or managing relations with trade counterparties and vendors. This category covers errors in data entry, collateral management, and incomplete legal documentation. It focuses on the breakdown of the standardized steps required to complete a business transaction, leading to financial loss or operational disruption for the banking organization.
- 53.** (D) Coordinated management of all risks across the organisation associated with all undertaken activities.
Integrated Risk Management is the coordinated management of all risks across the entire organization. It moves away from managing risks in isolated silos, recognizing that credit, market, and operational risks are often interrelated. This holistic approach ensures that every activity undertaken by the bank is evaluated for its total risk impact, leading to better capital optimization and strategic decision-making.
- 54.** (C) Damage to physical assets
Losses resulting from natural disasters like earthquakes that cause structural damage to headquarters or data centers are classified under damage to physical assets. This category specifically addresses the destruction of the bank's tangible property due to external events. While it may lead to business disruption, the primary event is the physical loss of hardware, equipment, and buildings owned by the bank.
- 55.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Integrated risk management prioritizes optimizing capital utilization by assessing aggregate risk levels across the bank. Since risks create instability, banks must hold capital that matches potential worst-case scenarios. The Risk-Adjusted Return on Capital metric is

essential here, as it measures whether the returns generated by a business unit justify the amount of capital being put at risk during its operations.

- 56.** (A) The board of directors should take the lead in establishing a strong risk management culture.
A core principle of operational risk management is that the board of directors must lead in establishing a strong risk culture. The board is responsible for approving the overall framework and ensuring that senior management implements it effectively. This top-down approach ensures that risk management is prioritized throughout the bank and is not viewed as just a compliance-driven exercise.
- 57.** (A) Completely eliminates all earnings volatility and downside risk potential.
Integrated Risk Management aims to align risk with strategy, enhance transparency, and improve earnings growth. However, it is impossible for any framework to completely eliminate all earnings volatility or downside risk potential. The goal is to manage risks within defined appetite levels and minimize the impact of unexpected events, rather than attempting to achieve a state of zero risk.
- 58.** (B) P-3, Q-4, R-2, S-1
Under the principles of sound management, Principle 3 focuses on the board's role in approving and reviewing the framework. Principle 5 requires senior management to develop a robust governance structure. Principle 7 mandates an approval process for new products to assess operational risks, while Principle 10 emphasizes the importance of business resiliency and continuity planning for potential disruptions.
- 59.** (C) I, II, III, and IV
The drive for effective risk management comes from global market developments, concerns over business continuity, and rapid technological changes. Banks also seek to limit earnings volatility to protect shareholder value and enhance returns. While risk management ratings by agencies exist, the primary business challenges focus on operational reliability and adapting to the evolving technological landscape rather than the ratings themselves.

- (A) P-2, Q-3, R-4, S-1
- (B) P-3, Q-2, R-1, S-4
- (C) P-4, Q-1, R-2, S-3
- (D) P-2, Q-4, R-3, S-1

Oct/Nov 2018

7. Liquidity is defined as a bank's capacity to fund increases in assets and meet both expected and unexpected cash and collateral obligations:
- (A) At an optimal cost by maximizing the profitability of core deposits.
 - (B) At a reasonable cost and without incurring unacceptable losses.
 - (C) By primarily relying on the short-term borrowing mechanisms of the central bank.
 - (D) By utilizing unencumbered assets exclusively to cover overnight mismatches.

May/June 2010

8. Bank Alpha is facing sudden, unexpected liquidity shortfalls due to a market-wide credit freeze. The management realizes that while they have identified alternative funding sources, there is widespread confusion regarding who holds the authority to activate emergency borrowing lines and communicate with stakeholders. To resolve this structural weakness in the future, the bank should primarily refine its:
- (A) Intraday liquidity management strategies and payment settlement protocols.
 - (B) Contingency Funding Plan (CFP) invocation and escalation procedures.
 - (C) Core deposit allocation ratios and long-term retail funding distributions.
 - (D) Statutory liquidity ratio maintenance and regular regulatory reporting.

Oct/Nov 2015

9. According to liquidity risk management practices, liquidity risk tolerance may be expressed in multiple ways. Which of the following best represents a valid expression of risk tolerance?
- (A) Maximizing negative gaps in maturity dates unconditionally to increase yield.
 - (B) Fixing maturity tolerance levels under flow and ratio levels under stock approaches.
 - (C) Eliminating all unencumbered liquid assets to enhance short-term bank profitability.
 - (D) Removing limits on the transfer of liquidity across various separate legal entities.

May/June 2024

10. Consider the following statements regarding types of liquidity risk:
- I. Funding Liquidity Risk is the risk that a bank cannot easily offset or eliminate a position at the prevailing market price because of inadequate market depth.
 - II. Market Liquidity Risk is the risk that a bank will not be able to meet expected and unexpected cash flows efficiently without affecting daily operations.
- Which of the above statements is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2009

11. Consider the following statements regarding the components of 'Volatile Liabilities' defined in the structural liquidity statement:
- I. Deposits, borrowings, and bills payable up to 1 year.
 - II. Letters of credit - full outstanding.
 - III. Current deposits (CA) and Savings deposits (SA) payable above one year.
- Which of the above are correctly included in the definition of Volatile Liabilities?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2016

12. A liquidity problem in a bank could be the first symptom of brewing financial trouble. Which of the following is the most appropriate reason why such problems require rapid, enterprise-wide assessment?
- (A) They impact the bank's profitability margins for the ongoing financial quarter.
 - (B) They mandate immediate regulatory downgrades of the bank's credit rating levels.
 - (C) They disrupt balance sheets and trigger broader systemic disruptions.
 - (D) They lead to the automatic suspension of foreign exchange dealing licenses.

34. (C) Events C and D

For calculating average annual losses under the standardized approach, banks must include all operational loss events that meet or exceed the regulatory threshold of one hundred thousand rupees. In this scenario, only Event C and Event D surpass this limit. Events A and B are below the threshold and are therefore excluded from the specific calculation of average annual losses for the bank.

35. (D) I, II, III, and IV

The Advanced Measurement Approach requires a comprehensive set of inputs to determine capital charges. Banks must use internal loss data and external industry data to capture both frequent and rare events. Additionally, scenario analysis provides expert-driven insights into potential large-scale failures, while business environment and internal control factors adjust the model for current organizational conditions and control effectiveness.

36. (B) Only II is correct

Regulatory standards for the standardized approach require banks to record loss data net of any recoveries. This means that if a bank recovers funds through legal action or insurance claims, these amounts should be deducted from the original gross loss. This approach ensures that the capital charge reflects the actual economic loss sustained by the bank rather than theoretical gross amounts.

37. (C) II, III, I

Operation profiling begins with the identification and quantification of operational risks across various components. Once identified, these risks are prioritized based on their potential impact and concentration levels. Finally, this prioritized profile is used to formulate a comprehensive strategy for operational risk management and to design a risk-based audit plan to ensure ongoing monitoring and effective control of the bank.

38. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Regulators can mandate an Internal Loss Multiplier greater than one if a bank's loss data collection is substandard or non-compliant. This serves as a capital penalty, increasing

the regulatory requirement to account for the uncertainty caused by poor data quality. It encourages banks to improve their internal reporting systems and ensures they hold sufficient capital against potentially unmeasured operational risks.

39. (A) I, III, and V

A generic measurement approach estimates operational risk by combining the probability of occurrence with the potential financial impact. It also factors in the effectiveness of internal controls, which serves as a risk mitigator. Unlike the Basic Indicator Approach or Standardised Approach, it does not rely solely on gross income or fixed beta factors but uses these qualitative and quantitative organizational estimates.

40. (C) Both I and II are correct

Maintaining high-quality loss data requires both internal and external oversight. Banks must implement internal processes to independently review the accuracy and completeness of their data. Simultaneously, national supervisors are responsible for periodically reviewing these data sets to ensure they meet regulatory standards. This dual-layered review process ensures the reliability of the inputs used for calculating operational risk capital charges accurately.

41. (B) 20%

The Advanced Measurement Approach allows banks to recognize the risk-mitigating benefits of insurance, but this recognition is subject to a strict regulatory cap. Specifically, the total reduction in the operational risk capital charge resulting from insurance coverage cannot exceed twenty percent. This limit ensures that banks do not over-rely on insurance at the expense of maintaining adequate core capital reserves.

42. (B) The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events. This definition includes legal risk but specifically excludes strategic and reputational risks. It encompasses a wide range of failures, from human error and fraud to technical glitches

May/June 2013

18. Match the BCBS Principles in List I with their respective focus areas in List II:

List I: BCBS Principles

- P. Principle 3
- Q. Principle 5
- R. Principle 11
- S. Principle 13

List II: Focus Areas

- 1. Public disclosure of information
- 2. Formal contingency funding plan (CFP)
- 3. Sound process for identifying, measuring, monitoring and controlling liquidity risk
- 4. Senior management developing strategy, policies and practices

- (A) P-4, Q-3, R-2, S-1
- (B) P-3, Q-4, R-1, S-2
- (C) P-4, Q-1, R-3, S-2
- (D) P-2, Q-3, R-4, S-1

Oct/Nov 2019

19. The Risk Management Committee is responsible for evaluating the overall risks faced by the bank. Which of the following best describes the committee's composition as mandated by the guidelines?

- (A) The Chief Executive Officer, internal auditors, and senior compliance officers.
- (B) Independent directors, legal counsel, and heads of the audit and compliance teams.
- (C) Operating staff for liquidity monitoring and various Asset-Liability Committee members.
- (D) CEO/Chairman and Managing Director, plus heads of credit, market, and operational risk.

May/June 2025

20. Consider the following statements related to the principles of liquidity risk management:

- I. A bank should actively manage its intraday liquidity positions and risks to meet payment and settlement obligations.
- II. A bank should manage collateral positions differentiating between encumbered and unencumbered assets.
- III. Stress tests should be conducted on a regular basis for a variety of short-term and protracted institution-specific scenarios only.
- IV. A formal contingency funding plan (CFP) must include clear invocation and escalation

procedures.

Which of the above statements is/are correct?

- (A) I, II, and IV only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2005

21. What is the industry average for the ratio of (Loans + mandatory SLR + mandatory CRR + Fixed Assets) to Core Deposits?

- (A) 40%
- (B) 60%
- (C) 150%
- (D) 80%

May/June 2017

22. All of the following are considered key considerations in liquidity risk management, EXCEPT:

- (A) Extent of volatility of the deposits
- (B) Unplanned termination of government deposits
- (C) Degree of reliance on volatile sources of funding
- (D) Quality of maturing assets

Oct/Nov 2016

23. A mid-sized commercial bank experiences an unexpected surge in corporate deposit withdrawals. Despite having a robust portfolio of long-term retail advances, the bank struggles to secure immediate cash to cover these withdrawals without resorting to fire sales of its assets, which would significantly impact its financial condition. This scenario best illustrates:

- (A) Systemic Risk
- (B) Contagion Risk
- (C) Market Liquidity Risk
- (D) Funding Liquidity Risk

May/June 2007

24. Which of the following statements concerning the strategy for managing liquidity risk is incorrect?

- (A) The strategy should be appropriate for the nature, scale, and complexity of a bank's activities.
- (B) Banks should take into consideration their legal structures and key business lines when formulating the strategy.

Oct/Nov 2015

51. During an independent evaluation of Bank Sigma's liquidity risk management, the reviewers discover instances of non-compliance with the Board-approved prudential limits on liquidity transfers. According to internal control guidelines, what is the immediate expected action from the independent review process?
- Suspend the operations of the Asset-Liability Management Committee immediately.
 - Publicly disclose the non-compliance on the bank's website as per market discipline.
 - Revise Board-approved limits retroactively to ensure mathematical compliance levels.
 - Report issues requiring immediate attention for corrective action per Board policy.

May/June 2024

52. Consider the following statements regarding the significance of liquidity ratios:
- A high ratio of 'Temporary Assets / Total Assets' could impinge on asset utilization in terms of opportunity cost.
 - A high ratio of '(Loans + mandatory SLR + mandatory CRR + Fixed Assets) / Total Assets' signifies a high degree of illiquidity.
 - 'Volatile Liabilities / Total Assets' measures the extent to which assets are funded through a stable deposit base.
 - The industry average for 'Core deposits / Total Assets' is 50%.
- Which of the above statements is/are correct?
- I, II, and III only
 - I, II, and IV only
 - II, III, and IV only
 - I, III, and IV only

Oct/Nov 2009

53. A bank's Contingency Funding Plan (CFP) is triggered due to severe market-wide stress. The crisis management team needs to rapidly generate funds. According to sound CFP principles, which specific details should the plan ideally provide to assist the team in this exact moment?
- Comprehensive data regarding the exact macroeconomic causes of the market stress event.
 - Updated industry averages for stock liquidity ratios across all domestic institutions.
 - Details of sources, amounts, escalation procedures, and lead times needed to tap

funds.

- Historical profitability margins and net interest income of the bank over ten years.

May/June 2016

54. Arrange the following actions taken during the stress testing process in the correct chronological order:
- Identifying and quantifying sources of potential liquidity strain.
 - Reporting vulnerabilities to the Board and charting a plan of action.
 - Discussing results thoroughly by ALCO to determine mitigating actions.
 - Designing stress scenarios incorporating the bank's business and vulnerabilities.
- Which of the following represents the correct sequence?
- IV, I, III, II
 - I, IV, III, II
 - IV, III, I, II
 - III, IV, I, II

Oct/Nov 2022

55. Consider the following statements regarding the tolerance levels and controls for maturity mismatches:
- Controls should be undertaken currency-wise.
 - Controls apply to currencies which individually constitute 5% or more of a bank's consolidated overseas balance sheet.
 - Netting of inter-currency positions and maturity gaps is not allowed.
 - Banks should endeavour to broaden their base of long-term resources.
- Which of the above statements is/are correct?
- I, II, and III only
 - I, III, and IV only
 - II, III, and IV only
 - I, II, III, and IV

May/June 2008

56. An analyst calculates the 'Temporary Assets / Volatile Liabilities' ratio for a commercial bank and finds the result to be 0.50. According to the structural liquidity risk management framework, what does this ratio indicate?
- The ratio is less than 1, which indicates the possibility of a liquidity problem.
 - The bank holds excessive idle cash leading to high opportunity costs.

Oct/Nov 2008

31. Consider the following statements regarding the critical stock ratios for liquidity risk management:
- The numerator of the ratio '(Volatile liabilities – Temporary Assets) / (Earning Assets – Temporary Assets)' represents short-term, interest-sensitive funds.
 - A high and positive number for the ratio in Statement I implies some risk of illiquidity.
 - The industry average for 'Temporary Assets / Volatile Liabilities' is 60%.
 - The ratio '(Loans + mandatory SLR + mandatory CRR + Fixed Assets) / Core Deposits' has an industry average of 150%.
 - Banks must apply these ratios exclusively in US Dollars.

Which of the above statements is/are correct?

- I, II, III, and IV only
- I, III, IV, and V only
- II, III, IV, and V only
- I, II, IV, and V only

May/June 2009

32. An Indian bank with several overseas branches needs to ensure its asset-liability structure mismatch is appropriately controlled on a consolidated basis. According to guidelines, which division should centralize this monitoring system, and how frequently should the top management review the structural maturity mismatch position?
- The Risk Management Department on a monthly basis.
 - The International Division (ID) on a quarterly basis.
 - The Domestic Treasury Division on a fortnightly basis.
 - The Audit Committee on an annual basis.

Oct/Nov 2024

33. Bank Beta has Total Assets of Rs. 10,000 cr. Its Fixed Assets are Rs. 1,000 cr, Balances in current accounts with other banks are Rs. 200 cr, Intangible assets are Rs. 100 cr, and Other assets excluding leasing are Rs. 300 cr. Calculate the Earning Assets for Bank Beta.
- Rs. 8,600 cr
 - Rs. 8,400 cr
 - Rs. 9,000 cr
 - Rs. 9,700 cr

May/June 2012

34. Match the Liquidity Return Parts in List I with their required submission periodicity in List II:

List I: Liquidity Return Parts

- Statement for combined Indian operations (Part A3)
- Statement for overseas operations (Part B)
- Statement for consolidated bank operations (Part C)
- Time period within which Part B is required to be reported

List II: Periodicity

- Quarterly
 - Within 15 days from the reporting date
 - Fortnightly
 - Monthly
- P-3, Q-4, R-1, S-2
 - P-4, Q-3, R-2, S-1
 - P-3, Q-1, R-4, S-2
 - P-1, Q-2, R-3, S-4

Oct/Nov 2017

35. Consider the following statements regarding the requirements of a Contingency Funding Plan (CFP):

- CFPs should prepare the bank to manage scenarios of severe liquidity stress, including both bank-specific and market-wide stress.
- Contingency plans must be tested regularly to ensure their operational feasibility.
- Contingency plans must be reviewed by the Board at least on a quarterly basis.

Which of the above statements is/are correct?

- I and II only
- II and III only
- I and III only
- I, II, and III

May/June 2011

36. Consider the following statements concerning internal controls in liquidity risk management:

- A bank's management should ensure that an independent party regularly reviews and evaluates the various components of the bank's liquidity risk management process.
- The independent review process is strictly intended to report non-compliance issues exclusively to external credit rating agencies.

Which of the above statements is/are correct?

- Only I
- Only II
- Both I and II

- (C) Strategies should identify primary sources of funding for meeting daily operating cash outflows.
- (D) The strategy should focus exclusively on expected cash flow fluctuations, disregarding unexpected fluctuations.

Oct/Nov 2014

25. Arrange the following time buckets for the Statement of Structural Liquidity in their correct chronological sequence from the shortest to the longest duration:

- I. 15-30 days
II. 31 day to 2 mon
III. 8-14 days
IV. 2-7 days

Which of the following represents the correct sequence?

- (A) IV, III, I, II
(B) III, IV, II, I
(C) IV, I, III, II
(D) I, IV, III, II

May/June 2022

26. Select the correct statement regarding the relationship between solvency and liquidity.
- (A) A bank is considered solvent only if its total outside liabilities exceed its total realizable assets.
- (B) A bank is expected to be solvent in the short term and liquid in the long term.
- (C) Effective liquidity management is irrelevant to the long-term solvency of a bank.
- (D) A bank can be liquid but not solvent at a given point in time.

Oct/Nov 2021

27. Select the correct statement regarding the time buckets in the flow approach.
- (A) The maturity ladder helps in tracking the cash flow mismatches over a series of specified time periods.
- (B) The liquidity controls should encompass only individual maturity-bucket mismatches without considering cumulative mismatches.
- (C) Negative gaps indicate a situation where assets exceed liabilities within a specific time bucket.
- (D) The flow approach evaluates liquidity by calculating the core deposits to total assets ratio.

May/June 2015

28. Market Liquidity Risk is defined as the risk that a bank:
- (A) Inability to offset positions at market prices due to depth or disruption.
- (B) Inability to meet current and future cash flows without affecting operations.
- (C) Sudden and massive withdrawal of deposits driven by various non-economic factors.
- (D) Facing a negative gap where liabilities exceed assets in short-term maturity dates.

Oct/Nov 2020

29. During a period of heightened market volatility, the operating staff of a bank prepares a simulation showing a severe deterioration in the bank's liquidity position if short-term interest rates increase by 200 basis points. They recommend specific actions to maintain the liquidity position. To which body should this group present their findings and recommendations for ensuring adherence to risk limits and strategy implementation?
- (A) The Board of Directors
(B) The Risk Management Committee
(C) The Asset-Liability Management Committee (ALCO)
(D) The Audit Committee

May/June 2019

30. Read the following statements and select the correct option:
- Assertion (A): A bank should maintain a cushion of unencumbered, high quality liquid assets to be held as insurance against a range of liquidity stress scenarios.
- Reason (R): These assets are required to ensure there are no legal, regulatory, or operational impediments to obtaining funding when unsecured and secured funding sources are impaired.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2021

44. Regarding the overseas operations of Indian banks and branches of foreign banks in India, what is the core expectation of their liquidity management?
- (A) Overseas branches should rely entirely on the head office for daily operational liquidity.
 - (B) Indian banks' subsidiaries abroad are exempt from formulating liquidity policies.
 - (C) Foreign banks in India must consolidate their liquidity risk entirely with the host country's central bank reserves.
 - (D) Foreign banks operating in India should be self-reliant with respect to liquidity maintenance and management.

Oct/Nov 2007

45. Which of the following statements regarding the reporting of the liquidity return to the RBI is incorrect?
- (A) Part A1 for domestic currency, Indian operations is submitted to the regulator fortnightly.
 - (B) Reporting dates for fortnightly returns are fixed as the 15th and the last date of the month.
 - (C) If a reporting date is a holiday, the date shifts to the next working day.
 - (D) The reporting date for monthly and quarterly returns will be the last working day of the period.

May/June 2014

46. Bank Omega reports the following balances: Cash = Rs. 100 cr, Excess CRR balances = Rs. 50 cr, Balances with banks = Rs. 200 cr, Bills purchased up to 1 year = Rs. 150 cr, Swap funds (sell/buy) up to one year = Rs. 100 cr. Based on the components defined for liquidity ratios, what is the value of Temporary Assets?
- (A) Rs. 350 cr
 - (B) Rs. 600 cr
 - (C) Rs. 450 cr
 - (D) Rs. 500 cr

Oct/Nov 2023

47. The structural liquidity reporting requirements and time buckets were aligned by the Reserve Bank of India with effect from:
- (A) September 1, 1998
 - (B) February 1, 2016

- (C) February 1, 1999
- (D) October 1, 2007

May/June 2005

48. Read the following statements and select the correct option:
- Assertion (A): A very high 'Temporary Assets / Total Assets' ratio is always universally beneficial for a bank's financial performance.
- Reason (R): While it measures the extent of available liquid assets, a higher ratio could impinge on the asset utilization of the banking system in terms of the opportunity cost of holding liquidity.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2018

49. Which of the following statements is correct regarding the management of liquidity across currencies?
- (A) Banks prepare MAP statements for assessing liquidity mismatch in foreign currencies.
 - (B) Liquidity mismatch monitoring in foreign currencies is voluntary and not regulated.
 - (C) Banks must consolidate all currencies into one statement to enable gap netting.
 - (D) Stress testing outcomes are not relevant when analyzing strategies for individual units.

May/June 2010

50. Consider the following statements regarding the limits on maturity mismatches for overseas operations:
- I. Long-term resources should not fall below 70% of long-term assets.
 - II. Long and medium-term resources together should not fall below 80% of the long and medium-term assets.
- Which of the above statements is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2012

76. The statement “the crux of banking is managing mismatches” refers to the concept that:
(A) Banks naturally possess perfectly matched asset and liability portfolios.
(B) Banks must avoid mismatching tenors to generate interest income.
(C) Banks systematically match their foreign exchange inflows and outflows precisely to mitigate structural liquidity.
(D) Banks transform shorter tenor deposits into longer tenor advances to sustain their business model and profitability.

Oct/Nov 2017

77. Consider the following time buckets as per revised liquidity reporting requirements. Which of the following time buckets is incorrectly paired?
(A) 2-7 days
(B) 15-30 days
(C) 31 day to 2 mon
(D) >4 m to 6 m

May/June 2011

78. Consider the following statements regarding the governance of liquidity risk management as per BCBS Principles:
I. A bank should articulate a liquidity risk tolerance appropriate for its business strategy.
II. Senior management should report to the board of directors on a regular basis regarding liquidity developments.
III. The board of directors is responsible for reviewing and approving the strategy at least once every five years.
IV. A bank should incorporate liquidity costs, benefits, and risks in the internal pricing and performance measurement.
Which of the above statements is/are correct?
(A) I, II, and IV only
(B) I, III, and IV only
(C) II, III, and IV only
(D) I, II, III, and IV

Oct/Nov 2010

79. According to BCBS Principles, what is the primary goal of establishing a robust funding strategy?
(A) Ensure the bank conducts stress tests purely on protracted market-wide stress scenarios.
(B) Diversify funding sources and tenors while maintaining an ongoing presence in markets.
(C) Guarantee the centralization of mismatch structures within the domestic treasury division.
(D) Actively manage intraday liquidity positions exclusively for the domestic home currency.

May/June 2006

80. Consider the following parts of the Statement of Structural Liquidity reported to the RBI:
I. For domestic currency, Indian operations
II. For foreign currency, Indian operations
III. For combined Indian operations
IV. For overseas operations
V. For consolidated bank operations
Which of the above are required to be reported among the five distinct parts?
(A) I, II, III, and IV only
(B) I, III, IV, and V only
(C) II, III, IV, and V only
(D) I, II, III, IV, and V

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- (C) The bank has a stable deposit base effectively funding its long-term assets.
- (D) The bank relies heavily on wholesale funding from inter-bank markets.

Oct/Nov 2011

57. A bank is finalizing its “Part C – Statement of Structural Liquidity - For Consolidated Bank Operations” for the quarter ending on a day which is not a holiday. Within what time frame from the reporting date is the bank required to submit this quarterly return to the Reserve Bank of India?
- (A) Within a month
 - (B) Within a week
 - (C) Within 15 days
 - (D) Within 45 days

May/June 2020

58. The results of liquidity stress tests are extensively analyzed by the bank. What is the primary role of the Asset-Liability Management Committee (ALCO) regarding these outcomes?
- (A) Discuss results and take remedial actions to limit exposures and build cushions.
 - (B) Formally audit the mathematical accuracy of the models used for scenario testing.
 - (C) Publicly disclose the test outcomes to all retail depositors and shareholders.
 - (D) Adjust the statutory liquidity ratio as mandated by the central bank authorities.

Oct/Nov 2006

59. Consider the following statements regarding the Management Information System (MIS) for liquidity risk:
- I. It should provide timely and forward-looking information on the liquidity position.
 - II. Information should be placed periodically to the Board and ALCO under normal and stress situations.
 - III. It must cover liquidity positions only on an aggregate group basis, excluding subsidiary/branch basis.
 - IV. It should capture all sources of liquidity risk, including contingent risks.
 - V. It should have the ability to furnish more granular information during stress events.
- Which of the above statements is/are correct?
- (A) I, II, III, and IV only
 - (B) I, II, IV, and V only

- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

May/June 2013

60. Under the broad norms in respect of liquidity management, banks should not normally assume voluntary risk exposures extending beyond a period of:
- (A) Three years
 - (B) Ten years
 - (C) Five years
 - (D) Seven years

Oct/Nov 2019

61. The risk manager of Bank Gamma observes that the ratio of “Temporary Assets to Volatile Liabilities” has dropped from 1.2 to 0.8 over the last quarter. Considering the implications of this metric, what is the most logical conclusion the ALCO should draw from this shift?
- (A) The bank has completely eliminated its dependency on wholesale funding and market-sensitive borrowings.
 - (B) The bank’s basic earning assets are now fully supported by long-term core deposits and stable equity.
 - (C) The cover of liquid investments relative to volatile liabilities has weakened.
 - (D) The bank has successfully minimized the opportunity cost of holding excess liquidity in volatile times.

May/June 2025

62. Bank Zeta’s ALCO is revising its Contingency Funding Plan (CFP). The committee outlines a list of potential contingency funding sources but fails to establish a sequence of execution. To align with robust CFP practices, what specific procedure must the ALCO include to address this gap?
- (A) Include escalation procedures detailing when and how each action is activated.
 - (B) Restrict the bank to a single, centralized funding source during times of stress.
 - (C) Defer all liquidity shortfalls to the Central Bank’s window without internal review.
 - (D) Implement a uniform operational limit capping all funding sources at equal values.

Oct/Nov 2005

63. Bank Epsilon recently suffered negative publicity concerning a specific asset class it

(D) Neither I nor II

Oct/Nov 2010

37. Which of the following pairs accurately matches a ratio component with its inclusion criteria?
- (A) Volatile Liabilities — Component-wise CCF of other contingent credit and commitments
 - (B) Temporary Assets — Investments up to two years
 - (C) Earning Assets — Fixed assets and Intangible assets
 - (D) Core deposits — Borrowings from RBI and call money

May/June 2006

38. Which of the following pairs incorrectly matches the term definition used for the purpose of maturity mismatch limits?
- (A) Short-term — Maturing within 6 months
 - (B) Medium-term — Maturing in 6 months and longer but within 3 years
 - (C) Long-term — Maturing in 3 years and longer
 - (D) Long-term — Maturing in 5 years and longer

Oct/Nov 2013

39. Read the following statements and select the correct option:
- Assertion (A): Liquidity risk reports generated by the MIS may include critical assumptions used in cash flow projections and key early warning indicators.
- Reason (R): These details provide sufficient detail to enable management to assess the sensitivity of the bank to changes in market conditions and its own financial performance.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2023

40. In designing liquidity stress scenarios, the nature of the bank's business and vulnerabilities should be taken into consideration. These scenarios incorporate risks associated with all of the following, EXCEPT:

- (A) Business activities
- (B) Products, including complex financial instruments
- (C) Funding sources
- (D) Imposition of new international corporate tax brackets

Oct/Nov 2025

41. Consider the following statements regarding the foundational concepts of liquidity risk management:
- I. Liquidity risk for banks mainly manifests on account of Funding liquidity risk and Market liquidity risk.
 - II. The organizational setup for liquidity risk management excludes the Asset Liability Management (ALM) Support Group.
 - III. Setting up an effective liquidity risk management policy is considered the first step towards liquidity management.
- Which of the above statements is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2018

42. Identify the incorrect statement regarding the definitions of variables used in liquidity risk ratios.
- (A) Volatile liabilities include borrowings from RBI and call markets.
 - (B) Temporary assets include investments up to one year.
 - (C) Swap funds (buy/sell) up to two years are included under volatile liabilities.
 - (D) Core deposits include all deposits (including CASA) above 1 year plus net worth.

Oct/Nov 2012

43. Bank Delta operates overseas and has a total consolidated overseas balance sheet where the US Dollar constitutes 15% of the total. Its long-term US Dollar assets are \$100 million. To adhere to the broad norms for liquidity management regarding limits on maturity mismatches, what is the minimum amount of long-term US Dollar resources the bank must maintain?
- (A) \$50 million
 - (B) \$70 million
 - (C) \$80 million
 - (D) \$100 million

- (C) Decreased concerns over the funding of off-balance sheet items.
- (D) Increased potential for deterioration in the bank's financial condition.

May/June 2015

- 70.** Consider the following responsibilities of the Asset Liability Management (ALM) Support Group:
- I. Analyzing, monitoring, and reporting the liquidity risk profile to the ALCO.
 - II. Preparing forecasts and simulations showing the effect of market condition changes.
 - III. Formulating and approving the contingent funding plan independently without Board oversight.
 - IV. Recommending actions needed to maintain the liquidity position.
- Which of the above statements correctly reflect the group's duties?
- (A) I, II, and III only
 - (B) I, II, and IV only
 - (C) II, III, and IV only
 - (D) I, III, and IV only

Oct/Nov 2020

- 71.** Toward the assessment of liquidity risk, which of the following is NOT classified as an Internal Banking Factor that could potentially lead to liquidity risk problems?
- (A) Concentration of deposits in the short-term tenor
 - (B) Rapid asset expansions exceeding available funds on the liability side
 - (C) Heavy reliance on short-term corporate/wholesale deposits
 - (D) Decreasing depositors' trust in the banking sector

May/June 2019

- 72.** Select the correct statement regarding the application of the critical stock ratios prescribed for liquidity management.
- (A) Rigidly adhere to industry averages without any deviation for all commercial institutions.
 - (B) Treat industry averages as mandatory minimum thresholds legally binding on all banks.
 - (C) Use these ratios exclusively for monitoring liquidity risk at the consolidated group level.
 - (D) Monitor ratios using internally defined

limits approved by the Board based on experience.

Oct/Nov 2008

- 73.** Consider the following statements regarding the documentation and reporting of stress test results:
- I. The results and action taken should be documented by banks and made available to the Reserve Bank/Inspecting Officers as and when required.
 - II. If stress test results indicate any vulnerability, they should be immediately reported to the Board.
 - III. The Department of Banking Supervision, Central Office, RBI, should be kept informed immediately in cases indicating vulnerability.
- Which of the above statements is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2009

- 74.** What is the fundamental role of the Asset-Liability Management Committee (ALCO) regarding liquidity risk tolerance?
- (A) Formally set and establish the explicit liquidity risk tolerance limits for the Board.
 - (B) Personally conduct independent reviews of the internal audit and compliance systems.
 - (C) Submit the fortnightly structural liquidity returns to the Central Office of the RBI.
 - (D) Adhere to risk limits set by the Board and implement the management strategy.

Oct/Nov 2024

- 75.** Read the following statements and select the correct option:
- Assertion (A): It is possible for a bank to be highly liquid in the short term but inherently insolvent in the long term.
- Reason (R): Solvency strictly depends on the total realizable value of assets being more than outside liabilities, whereas liquidity refers to having enough cash/funds to meet current obligations as they fall due.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true,

holds, triggering early warning signals of a potential liquidity stress event. To mitigate the potential for reputation contagion, which action is explicitly recommended by the sound principles of liquidity risk management?

- (A) Establish effective communication with counterparties, credit rating agencies, and stakeholders.
- (B) Instantly liquidate all unencumbered assets regardless of current market depth levels.
- (C) Halt all intraday payment and settlement obligations to preserve remaining cash flows.
- (D) Shift all volatile liabilities to off-balance sheet exposure accounts to mask risk.

May/June 2017

- 64.** A global banking group operates in multiple diverse jurisdictions with varying home and host country regulatory requirements. When formulating its strategy for managing liquidity risk, the bank must inherently consider all of the following structural elements, EXCEPT:

- (A) The uniform application of a single centralized statutory liquidity ratio across all foreign jurisdictions regardless of host country laws.
- (B) The legal structures and key business lines of the banking group.
- (C) The breadth and diversity of markets and products.
- (D) Primary sources of funding for meeting expected and unexpected cash flow fluctuations.

Oct/Nov 2016

- 65.** What is the primary objective of having an independent party regularly review a bank's liquidity risk management process?

- (A) To eliminate the need for stress testing by the ALM Support Group.
- (B) To act as a direct substitute for the Risk Management Committee in approving strategies.
- (C) To assess the extent to which the management complies with regulatory instructions as well as its own internal policies.
- (D) To reduce the operational costs associated with daily liquidity MIS reporting.

May/June 2007

- 66.** Consider the following statements based on the principles of public disclosure regarding liquidity risk:

- I. A bank should publicly disclose information on a regular basis to enable market participants to make an informed judgment about its liquidity risk management framework.
- II. Disclosing liquidity position information publicly is discouraged as it inevitably leads to reputational contagion and deposit runs.

Which of the above statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2014

- 67.** All of the following are components or conditions involved in determining "Core deposits" EXCEPT:

- (A) Deposits (including CASA) above 1 year
- (B) Net worth
- (C) Borrowings from RBI and call markets
- (D) Data as reported in the structural liquidity statement

May/June 2022

- 68.** Consider the following statements regarding key considerations in Liquidity Risk Management:

- I. Historical trend of stability of deposits
- II. Market reputation
- III. Availability of undrawn standbys
- IV. Impact of off-balance sheet exposures on the balance sheet
- V. Guaranteed central bank bailouts

Which of the above statements is/are correct?

- (A) I, II, III, and V only
- (B) I, II, III, and IV only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2021

- 69.** According to sound liquidity principles, early warning signals utilized by senior management to monitor potential liquidity stress events may include:

- (A) Positive publicity concerning an asset class owned by the bank.
- (B) Narrowing debt or credit default swap spreads.

ANSWERS

NODIA

1. (D) High off-balance sheet exposures — Internal Banking Factor

Liquidity risk drivers are categorized as internal or external. Internal factors include high off-balance sheet exposures, rapid asset expansion, and heavy reliance on short-term wholesale deposits. External factors encompass economic performance and market-wide changes in depositor trust. Managing internal factors involves monitoring commitments and contingent liabilities that might impact the bank's cash flow and overall funding stability.

2. (C) Preparing forecasts and simulations regarding changes in market conditions.

The Board of Directors holds the ultimate responsibility for liquidity risk management, including approving strategies and policies. However, the preparation of technical forecasts and simulations regarding market conditions is the specific function of the ALM Support Group. This group provides analytical data to the Asset-Liability Management Committee, ensuring senior management makes informed decisions based on projected scenarios.

3. (C) 'ICU' risk

Banks often refer to liquidity risk as ICU risk because it manifests rapidly in the short term and requires immediate, intensive care. Unlike solvency risk, which is a long-term concern regarding the total value of assets versus liabilities, liquidity issues can cause an otherwise healthy institution to fail quickly if immediate cash flow demands are unmet and funding is unavailable.

4. (C) Assertion (A) is true, but Reason (R) is false. The flow approach is considered superior because it forecasts liquidity at various future points by tracking cash flow mismatches across maturity buckets. In contrast, the stock approach relies on static ratios derived from current balance sheet data to indicate a point-in-time snapshot, rather than historical action. Therefore, the flow approach provides a more dynamic and forward-looking perspective necessary for

effective proactive liquidity risk management and operational stability.

- (A) I and II only

Basel Committee principles mandate that banks maintain a robust framework with a cushion of high-quality liquid assets and clearly defined risk tolerance levels. While the Board of Directors approves overall strategies, senior management is responsible for the daily development and implementation of policies. This distinction ensures that high-level oversight and operational execution are effectively separated within the bank's governance structure.

6. (A) P-2, Q-3, R-4, S-1

Industry averages serve as benchmarks for monitoring bank liquidity. Specifically, temporary assets to total assets should average forty percent, while core deposits to total assets should be around fifty percent. Furthermore, the ratio of temporary assets to volatile liabilities is typically sixty percent, and the ratio of long-term assets to total assets averages approximately eighty percent across the banking sector.

7. (B) At a reasonable cost and without incurring unacceptable losses.

Liquidity represents the ability of a bank to fund increases in assets and meet all cash obligations, whether expected or unexpected. A critical aspect of this definition is the capacity to obtain these funds at a reasonable cost and without incurring unacceptable losses. This ensures the bank remains operational and stable during both normal conditions and periods of market stress.

8. (B) Contingency Funding Plan (CFP) invocation and escalation procedures.

When a bank faces liquidity shortfalls but lacks clear authority lines for emergency borrowing, it indicates a deficiency in its Contingency Funding Plan. Effective plans must include specific invocation and escalation procedures to guide staff during a crisis. Refining these protocols ensures that responsibilities are clearly assigned and that communication with stakeholders

78. (A) I, II, and IV only

Basel principles require banks to articulate risk tolerance, incorporate liquidity costs into internal pricing, and ensure senior management reports regularly to the Board. While the Board of Directors is responsible for approving the liquidity strategy, it must review and re-approve this strategy much more frequently than every five years to reflect changing market conditions and evolving institutional risk profiles.

79. (B) Diversify funding sources and tenors while maintaining an ongoing presence in markets.

The primary goal of a robust funding strategy according to Basel principles is to ensure a bank has diverse sources and tenors of funding. This prevents over-reliance on any single market or funder. By maintaining an ongoing presence in various markets, a bank ensures it can raise funds quickly and efficiently, even during periods of stress when specific markets become illiquid.

80. (D) I, II, III, IV, and V

The structural liquidity return to the regulator consists of five distinct parts to provide a comprehensive view of risk. These include statements for domestic and foreign currency Indian operations, combined Indian operations, overseas operations, and consolidated bank operations. Reporting all five parts ensures that liquidity risks are monitored at every level, from individual currency exposures to the entire banking group's position.

are used, it is vital to adopt futuristic strategies within the risk framework. The flow approach tracks mismatches over time, while the stock approach utilizes specific static ratios.

18. (A) P-4, Q-3, R-2, S-1

Basel principles provide a structured framework for liquidity risk governance. Principle three emphasizes the role of senior management in developing strategies and policies. Principle five focuses on the process for identifying and controlling risk, while principle eleven mandates a formal contingency funding plan. Finally, principle thirteen requires the public disclosure of information to foster market discipline and institutional transparency.

19. (D) CEO/Chairman and Managing Director, plus heads of credit, market, and operational risk.
The Risk Management Committee is responsible for evaluating the comprehensive risk profile of the bank, including liquidity risk. To ensure effective oversight, its composition typically includes the Chief Executive Officer or the Chairman and Managing Director, along with the senior executives heading the credit, market, and operational risk departments. This ensures high-level decision-making is informed by various risk perspectives.

20. (A) I, II, and IV only

Banks must actively manage intraday liquidity positions and differentiate between encumbered and unencumbered collateral. A formal contingency funding plan with clear escalation procedures is also essential. However, stress tests should not be limited only to institution-specific scenarios; they must also encompass market-wide stress and combinations of both to ensure the bank is prepared for various possible crises.

21. (C) 150%

The ratio of loans, mandatory statutory liquidity ratio, mandatory cash reserve ratio, and fixed assets to core deposits provides insight into a bank's long-term asset-liability structure. The industry average for this specific ratio is approximately one hundred and fifty percent. This benchmark helps banks assess whether their long-term asset base is adequately supported by stable, long-term core funding sources.

22. (B) Unplanned termination of government deposits

Key considerations in liquidity risk management include the volatility of deposits, the degree of reliance on volatile funding sources, and the quality of maturing assets. These factors help banks evaluate their overall stability and potential for cash flow shortages. While unplanned terminations of specific deposits are risks, they fall under the broader category of assessing deposit stability and historical volatility.

23. (D) Funding Liquidity Risk

Funding liquidity risk is the inability of a bank to meet its obligations as they come due without incurring significant losses. In this scenario, the bank cannot cover sudden corporate deposit withdrawals because its funds are tied up in long-term advances. The struggle to secure immediate cash without resorting to fire sales of assets is a classic example of this risk.

24. (D) The strategy should focus exclusively on expected cash flow fluctuations, disregarding unexpected fluctuations.

A robust liquidity risk management strategy must be tailored to the bank's scale and legal structure. It is essential that the strategy identifies primary funding sources for daily operations. Most importantly, the strategy cannot focus exclusively on expected fluctuations; it must also account for unexpected cash flow changes and potential market disruptions to ensure the bank's continued financial stability.

25. (A) IV, III, I, II

The Statement of Structural Liquidity uses specific time buckets to track cash flows. The correct chronological sequence starting from the shortest duration is two to seven days, followed by eight to fourteen days. Next is the fifteen to thirty days bucket, and finally the thirty-one day to two-month bucket. Organizing data this way helps identify near-term liquidity mismatches effectively.

26. (D) A bank can be liquid but not solvent at a given point in time.

Liquidity refers to a bank's ability to meet immediate cash obligations, while solvency concerns whether total assets exceed total liabilities. It is possible for a bank to possess

remains organized during unexpected market-wide stress events.

9. (B) Fixing maturity tolerance levels under flow and ratio levels under stock approaches.

Liquidity risk tolerance is best expressed by establishing specific limits under both flow and stock approaches. This involves fixing maturity tolerance levels for future time buckets to manage mismatches and setting ratio levels to monitor structural liquidity. Such a dual approach allows banks to maintain a balanced risk profile while ensuring they have sufficient funds available for daily operational needs.

10. (D) Neither I nor II

Funding liquidity risk arises when a bank cannot meet expected and unexpected cash flow needs efficiently without impacting operations. Market liquidity risk occurs when a bank is unable to offset a position at the prevailing price due to inadequate market depth. Since the provided definitions were interchanged in the statements, neither correctly describes the specific type of risk mentioned.

11. (A) I and II only

Volatile liabilities include deposits, borrowings, and bills payable maturing within one year, along with the full outstanding amount of letters of credit. These items represent short-term obligations that are sensitive to market changes and depositor behavior. In contrast, current and savings deposits that remain stable for periods exceeding one year are generally classified as core deposits within the framework.

12. (C) They disrupt balance sheets and trigger broader systemic disruptions.

Liquidity problems often serve as early indicators of deeper financial distress within a banking institution. Because a failure to meet immediate obligations can rapidly disrupt the bank's balance sheet, it may lead to wider systemic disruptions across the entire financial sector. Rapid, enterprise-wide assessments are therefore crucial to prevent a localized liquidity issue from escalating into a full-scale systemic crisis.

13. (A) P-2, Q-4, R-3, S-1

Governance structures assign specific duties to different bodies. The Board of Directors

holds overall responsibility for liquidity risk management, while the Risk Management Committee evaluates all risks faced by the bank. The Asset-Liability Management Committee implements management strategies, and the ALM Support Group focuses on analyzing and reporting the liquidity risk profile to ensure ongoing operational compliance and informed decisions.

14. (C) A bank should establish a funding strategy that relies exclusively on a single highly liquid market to minimize diversification costs.

Sound liquidity risk management requires a diversified funding strategy across various sources and tenors. Relying exclusively on a single market, even if highly liquid, creates a concentration risk that could be detrimental if that specific market becomes impaired. Diversification ensures that a bank maintains ongoing access to funds and minimizes the costs associated with potential market disruptions or sudden freezes.

15. (A) P-1, Q-2, R-3, S-4

Specific ratios highlight different aspects of a bank's liquidity profile. The ratio of core deposits to total assets measures how well stable funds support the balance sheet. Temporary assets to total assets indicate available liquid resources, while temporary assets to volatile liabilities show the cover against sensitive funds. Volatile liabilities to total assets reveal the extent of short-term funding reliance.

16. (A) They accept deposits with shorter tenors and provide advances for longer periods.

Banks act as maturity transformation agents by accepting deposits with shorter tenors and utilizing those funds to provide advances or loans for much longer periods. This process is fundamental to the banking business model as it bridges the gap between the needs of short-term savers and long-term borrowers, although it inherently creates structural liquidity mismatches that require careful management.

17. (B) I, IV, and V only

Effective liquidity risk management involves identifying risks across all on and off-balance sheet positions and focusing on time buckets with negative gaps. While ratio-based stock approaches and cash flow-based flow approaches

35. (A) I and II only

A Contingency Funding Plan should prepare a bank for severe liquidity stress, including institution-specific and market-wide scenarios. It is crucial to test these plans regularly to confirm their operational feasibility during a crisis. While management monitors liquidity daily, the Board of Directors is generally required to review the overall contingency funding plan on an annual basis rather than quarterly.

36. (A) Only I

Sound internal controls require that an independent party regularly evaluates the bank's liquidity risk management process. This review assesses compliance with internal policies and regulatory requirements. However, the purpose of this independent review is not to report exclusively to external rating agencies, but to provide senior management and the Board with an objective assessment of the bank's risk framework.

37. (A) Volatile Liabilities — Component-wise CCF of other contingent credit and commitments

Volatile liabilities are defined to include various sensitive funding sources, including a component-wise credit conversion factor for other contingent credit and commitments. This ensures that potential off-balance sheet demands are accounted for in the liquidity analysis. Other components like core deposits focus on stable funding above one year, while temporary assets generally include liquid investments maturing within a short timeframe.

38. (D) Long-term — Maturing in 5 years and longer

In the context of maturity mismatch limits, specific tenors are defined to categorize assets and liabilities. Short-term refers to items maturing within six months, while medium-term includes those maturing between six months and three years. Long-term is correctly defined as maturing in three years and longer. Therefore, classifying long-term as only five years and longer is an incorrect definition.

39. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

A robust Management Information System generates liquidity reports that include critical

assumptions and early warning indicators. These details are essential because they allow management to assess how sensitive the bank is to shifts in market conditions or internal financial performance. By providing forward-looking data, the MIS enables the Asset-Liability Management Committee to make informed decisions regarding proactive mitigation.

40. (D) Imposition of new international corporate tax brackets

Liquidity stress scenarios are designed based on the bank's specific business activities, complex financial products, and various funding sources. They aim to model potential strains on cash flow. While macroeconomic factors are considered, the imposition of new international corporate tax brackets is generally not a primary focus for liquidity stress testing, which concentrates on market depth and funding availability.

41. (C) I and III only

Liquidity risk primarily manifests through funding and market liquidity risks. Establishing an effective risk management policy is the vital first step in managing these exposures. The organizational structure for this management includes the Board, the Risk Management Committee, the Asset-Liability Management Committee, and the ALM Support Group, which provides the necessary analytical and reporting functions for senior management oversight.

42. (C) Swap funds (buy/sell) up to two years are included under volatile liabilities.

The definitions of variables used in liquidity ratios are specific. Volatile liabilities include borrowings from the central bank and call markets. Temporary assets consist of investments maturing within one year. However, swap funds are included under volatile liabilities only if they mature within one year. Defining them as maturing up to two years for this category is incorrect according to established guidelines.

43. (B) \$70 million

Guidelines for overseas operations specify that long-term resources should not fall below seventy percent of long-term assets. Since Bank Delta has long-term US Dollar assets totaling one hundred million dollars, it must maintain a minimum of seventy million dollars in long-term resources

- 61.** (C) The cover of liquid investments relative to volatile liabilities has weakened.
When the ratio of temporary assets to volatile liabilities drops significantly, it indicates that the bank has fewer liquid assets available to cover its short-term, sensitive liabilities. This decline suggests that the bank's liquidity cushion is eroding, thereby increasing its vulnerability to sudden cash flow demands. The ALCO should conclude that the cover of liquid investments relative to volatile liabilities has weakened.
- 62.** (A) Include escalation procedures detailing when and how each action is activated.
A Contingency Funding Plan is ineffective without a clear sequence of execution and assigned responsibilities. To address the absence of an execution sequence, the ALCO must implement escalation procedures. These procedures specify exactly when and how each funding source should be activated and who has the authority to make those decisions, ensuring a coordinated and rapid response during stress.
- 63.** (A) Establish effective communication with counterparties, credit rating agencies, and stakeholders.
Reputation risk is closely linked to liquidity risk, as negative publicity can trigger deposit runs. To mitigate this, sound principles recommend establishing effective communication channels with counterparties, credit rating agencies, and other stakeholders. Providing transparent and timely information helps maintain market confidence and can prevent a localized issue from spiraling into a significant liquidity crisis due to reputational contagion issues.
- 64.** (A) The uniform application of a single centralized statutory liquidity ratio across all foreign jurisdictions regardless of host country laws.
When managing liquidity risk across diverse jurisdictions, banks must consider their legal structures, business lines, and the variety of products they offer. They also need to identify primary funding sources for both expected and unexpected needs. However, they cannot apply a single uniform statutory liquidity ratio globally, as each host country has its own specific regulatory and legal requirements to follow.
- 65.** (C) To assess the extent to which the management complies with regulatory instructions as well as its own internal policies.
The primary objective of an independent review is to provide an objective evaluation of the bank's liquidity risk management framework. It assesses whether the management is adhering to both external regulatory instructions and the bank's own internal policies. This process helps identify weaknesses in the risk management system and ensures that the Board's approved strategies are being correctly and consistently implemented.
- 66.** (A) Only I
Public disclosure is a fundamental principle of market discipline. Regularly disclosing information about the liquidity risk management framework allows market participants, such as depositors and investors, to make informed judgments about the bank's stability. Contrary to causing runs, transparent disclosure generally fosters trust and confidence in the institution, provided the bank maintains a robust and well-managed liquidity risk profile.
- 67.** (C) Borrowings from RBI and call markets.
Core deposits are the stable portion of a bank's funding and include net worth as well as all deposits, including current and savings accounts, that mature after one year. These are identified through data in the structural liquidity statement. Borrowings from the central bank and call markets are considered volatile liabilities rather than core deposits due to their short-term and sensitive nature.
- 68.** (B) I, II, III, and IV only
Key considerations for managing liquidity include evaluating the historical stability of deposits, monitoring market reputation, and ensuring the availability of undrawn standby credit lines. Banks must also assess how off-balance sheet exposures could impact their balance sheets. However, assuming guaranteed central bank bailouts is not a sound principle, as banks are expected to maintain self-sufficiency and independent resilience.
- 69.** (D) Increased potential for deterioration in the bank's financial condition.
Senior management uses early warning signals to identify emerging liquidity stress. An increased

52. (B) I, II, and IV only

A high temporary assets ratio indicates liquid funds but also implies high opportunity costs. Conversely, a high ratio of loans and fixed assets to total assets suggests significant illiquidity. The industry average for core deposits to total assets is fifty percent. However, the ratio of volatile liabilities to total assets measures short-term funding reliance, not the stability of the deposit base.

53. (C) Details of sources, amounts, escalation procedures, and lead times needed to tap funds.

During a liquidity crisis, a Contingency Funding Plan must provide actionable information to the management team. This includes identifying specific funding sources, the amounts available from each, and the lead times required to access those funds. Furthermore, clear escalation procedures are necessary to ensure that the correct individuals have the authority to activate these emergency measures without any delay.

54. (A) IV, I, III, II

The stress testing process begins with designing scenarios based on the bank's vulnerabilities. Once scenarios are set, the bank identifies and quantifies potential sources of liquidity strain. The Asset-Liability Management Committee then discusses these results to determine necessary mitigating actions. Finally, any significant vulnerabilities and the planned course of action are reported to the Board for oversight and approval.

55. (B) I, III, and IV only

Liquidity controls must be managed on a currency-wise basis, and netting gaps between different currencies is prohibited. Banks are also encouraged to broaden their long-term resource base to enhance stability. These controls typically apply to any currency that constitutes ten percent or more of the bank's consolidated overseas balance sheet, ensuring significant currency exposures are appropriately and individually monitored.

56. (A) The ratio is less than 1, which indicates the possibility of a liquidity problem.

The ratio of temporary assets to volatile liabilities measures the coverage of short-term liabilities by liquid assets. A ratio of zero point five indicates

that the bank only has enough liquid assets to cover half of its volatile liabilities. Because this value is less than one, it signals a potential liquidity problem and suggests the bank may struggle during a surge in withdrawals.

57. (C) Within 15 days

Banks are required to submit various parts of their structural liquidity statements to the Reserve Bank of India. For Part C, which covers the statement of structural liquidity for consolidated bank operations, the reporting frequency is quarterly. These quarterly returns must be submitted within fifteen days from the reporting date to ensure the regulator can monitor the group's overall liquidity position.

58. (A) Discuss results and take remedial actions to limit exposures and build cushions.

The Asset-Liability Management Committee plays a central role in responding to the results of liquidity stress tests. After analyzing the outcomes, the committee is responsible for discussing the findings and implementing remedial actions. These actions may include limiting certain exposures or building up liquidity cushions to ensure the bank remains resilient under the various stressed conditions identified in the simulations.

59. (B) I, II, IV, and V only

A bank's Management Information System must provide timely, forward-looking information to the Board and ALCO. It should capture all sources of risk, including contingent liabilities, and be capable of providing granular data during stress events. Furthermore, the MIS must cover liquidity positions on both an aggregate group basis and an individual subsidiary or branch basis for comprehensive institutional oversight.

60. (B) Ten years

Broad liquidity management norms suggest that banks should exercise caution regarding long-term commitments. Specifically, banks are advised not to normally assume voluntary risk exposures that extend beyond a period of ten years. This guideline helps institutions manage their structural maturity mismatches and ensures they do not over-commit their resources to exceptionally long-term projects that could potentially impair future liquidity.

enough cash to meet current demands, making it liquid, while its total realizable assets are worth less than its total liabilities, rendering it insolvent. Long-term survival requires maintaining both liquidity and solvency.

- 27.** (A) The maturity ladder helps in tracking the cash flow mismatches over a series of specified time periods.

The flow approach involves creating a maturity ladder to track cash flow mismatches over a series of specified future time periods. This allows management to see when shortfalls may occur. Liquidity controls should consider both individual maturity-bucket gaps and cumulative mismatches. Negative gaps specifically occur when the liabilities maturing in a certain time bucket exceed the assets maturing in that period.

- 28.** (A) Inability to offset positions at market prices due to depth or disruption.

Market liquidity risk is defined as the risk that an institution cannot easily offset or eliminate a position at the current market price. This usually occurs because of inadequate market depth or a significant market disruption. It differs from funding liquidity risk, as it focuses on the tradability of assets rather than the bank's ability to meet its immediate cash flow obligations.

- 29.** (C) The Asset-Liability Management Committee (ALCO)

The Asset-Liability Management Committee is the primary body responsible for implementing liquidity risk strategies and ensuring adherence to risk limits. When the operating staff or ALM Support Group prepares simulations and recommends actions based on changing market conditions, they present these findings to the committee. The committee then decides on remedial actions to maintain the bank's liquidity position.

- 30.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Maintaining a cushion of unencumbered, high-quality liquid assets serves as an insurance policy against liquidity stress scenarios. These assets are vital because they can be easily converted into cash even when other funding sources are impaired. Having such a cushion ensures that

legal or operational barriers do not prevent the bank from obtaining the necessary funding during a financial crisis.

- 31.** (A) I, II, III, and IV only

Stock ratios are essential tools for monitoring liquidity, such as the ratio comparing interest-sensitive funds to earning assets. A high positive number here suggests potential illiquidity. Standard industry averages include sixty percent for temporary assets to volatile liabilities and one hundred and fifty percent for the ratio of long-term assets to core deposits. These ratios are applied across various currencies.

- 32.** (B) The International Division (ID) on a quarterly basis.

For Indian banks with overseas branches, the International Division is responsible for centralizing the monitoring system to ensure structural maturity mismatches are controlled. This monitoring occurs on a consolidated basis. To maintain proper oversight, the top management of the bank is required to review the structural maturity mismatch position of its international operations at least on a quarterly basis.

- 33.** (B) Rs. 8,400 cr

Earning assets are calculated by subtracting non-earning items from total assets. In this case, start with ten thousand crore and deduct fixed assets of one thousand crore, current account balances with other banks of two hundred crore, intangible assets of one hundred crore, and other non-leasing assets of three hundred crore. The resulting value for earning assets is eight thousand four hundred crore.

- 34.** (A) P-3, Q-4, R-1, S-2

Different parts of the liquidity return have specific reporting schedules. The statement for combined Indian operations is submitted fortnightly. Returns for overseas operations are reported monthly, while consolidated bank operation statements are required quarterly. Additionally, the specific statement for overseas operations must be submitted within fifteen days from the reporting date to ensure the regulator receives timely information on international risks.

potential for deterioration in the bank's financial condition is a primary indicator. Other signals include widening credit default swap spreads or growing concerns among market participants about the bank's ability to fund off-balance sheet items. These indicators prompt the management to take proactive measures before a crisis.

70. (B) I, II, and IV only

The ALM Support Group is responsible for the analytical side of liquidity management, including reporting the liquidity risk profile and preparing future-oriented simulations. They also recommend necessary actions to the Asset-Liability Management Committee. However, they do not independently formulate and approve the contingency funding plan; such strategic plans require formal approval from the bank's Board of Directors to be valid.

71. (D) Decreasing depositors' trust in the banking sector

Internal banking factors that drive liquidity risk are those within the bank's control, such as deposit concentration in short tenors, rapid asset expansion, and heavy reliance on wholesale funding. External factors are those outside the bank's direct control, such as a general decrease in depositor trust across the entire banking sector or poor national economic performance during a recession.

72. (D) Monitor ratios using internally defined limits approved by the Board based on experience.

While industry averages provide useful benchmarks, they are not intended to be rigid or mandatory legal minimums for all banks. Instead, each bank should use these ratios to monitor its liquidity risk using internally defined limits. These limits must be approved by the Board of Directors and should be based on the bank's specific historical experience, business model, and risk tolerance.

73. (D) I, II, and III

Banks are required to document all stress test results and subsequent actions, making them available to regulators during inspections. If these tests reveal any vulnerabilities, the findings must be reported to the Board immediately. Furthermore, the bank must keep the Reserve Bank of India's Department of Banking

Supervision informed of such vulnerabilities to ensure proper regulatory oversight of risks.

74. (D) Adhere to risk limits set by the Board and implement the management strategy.

The Asset-Liability Management Committee is an operational body that works within the parameters established by the Board. Its fundamental role is to implement the liquidity risk management strategy and ensure that the bank's activities adhere to the specific risk tolerance limits set by the Board. It translates high-level policy into daily actions to maintain the bank's desired overall liquidity profile.

75. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Solvency and liquidity are distinct concepts. A bank is solvent if its total assets are worth more than its liabilities, while it is liquid if it has enough cash to meet current obligations. A bank can be liquid because it has cash on hand, yet be insolvent if the long-term value of its assets has collapsed below its total debt obligations.

76. (D) They transform shorter tenor deposits into longer tenor advances to sustain their business model and profitability.

The statement emphasizes that maturity transformation is the core of the banking business. Banks take in short-term deposits and lend those funds out as long-term loans. This inherently creates maturity mismatches between the bank's assets and liabilities. Managing these mismatches effectively is essential for both generating interest income and ensuring the bank can always meet its daily withdrawal demands.

77. (D) >4 m to 6 m

The revised liquidity reporting framework uses specific time intervals to categorize cash flows. Standard buckets include two to seven days, fifteen to thirty days, and thirty-one days to two months. The bucket labeled greater than four months to six months is not a standard interval in the prescribed structural liquidity statement, making it the incorrectly paired option in this specific context.

to comply with these maturity mismatch norms. This ensures that long-term lending is adequately supported by stable funding.

44. (D) Foreign banks operating in India should be self-reliant with respect to liquidity maintenance and management.

Foreign banks operating in India are expected to be self-reliant regarding their liquidity maintenance and management. They should not rely exclusively on their head offices for daily operational needs. Similarly, Indian banks with overseas branches must ensure their foreign units have robust, independent liquidity policies that comply with host country regulations while remaining aligned with the group's overall risk strategy.

45. (C) If a reporting date is a holiday, the date shifts to the next working day.

Liquidity returns are submitted to the regulator at fixed intervals, such as fortnightly for domestic operations. The reporting dates are typically the fifteenth and the last day of the month. If a reporting date falls on a holiday, the deadline is generally moved to the preceding working day rather than the next working day to ensure timely and consistent regulatory oversight.

46. (B) Rs. 600 cr

Temporary assets are composed of highly liquid items. For Bank Omega, this includes cash of one hundred crore, excess CRR balances of fifty crore, balances with other banks of two hundred crore, bills purchased up to one year of one hundred and fifty crore, and swap funds up to one year of one hundred crore. Adding these components results in six hundred crore.

47. (B) February 1, 2016

The Reserve Bank of India updated the structural liquidity reporting requirements to ensure better alignment with international standards and evolving market practices. These revised time buckets and reporting formats became effective for the reporting period ending January 15, 2016. This alignment helps in providing a more granular and accurate picture of a bank's liquidity profile, facilitating better risk monitoring by both banks and regulators.

48. (D) Assertion (A) is false, but Reason (R) is true. A very high ratio of temporary assets to total assets is not always beneficial because it can indicate underutilized resources. While these assets provide a liquidity cushion, holding excessive liquid funds carries an opportunity cost, as these funds might have earned higher returns if invested in longer-term assets. Therefore, banks must strike a balance between maintaining sufficient liquidity and optimizing asset utilization.

49. (A) Banks prepare MAP statements for assessing liquidity mismatch in foreign currencies.

Banks utilize Maturity and Position (MAP) statements to assess and monitor liquidity mismatches specifically in foreign currencies. This is a regulated requirement, especially for currencies that represent a significant portion of the bank's liabilities. Netting maturity gaps across different currencies is generally not permitted, as liquidity in one currency may not be readily available to cover obligations in another during stress.

50. (C) Both I and II

Broad norms for managing liquidity in overseas operations include specific thresholds for resource allocation. Long-term resources must represent at least seventy percent of long-term assets to ensure stability. Additionally, the combined total of long and medium-term resources should not fall below eighty percent of the corresponding assets. These limits prevent excessive reliance on short-term funding for long-term international lending activities.

51. (D) Report issues requiring immediate attention for corrective action per Board policy.

When an independent review identifies non-compliance with Board-approved liquidity limits, the immediate priority is to notify senior management and the Board. The review process is designed to highlight areas requiring attention so that corrective actions can be taken promptly. This ensures that the bank's actual risk profile remains within the boundaries defined by its established risk tolerance and management strategy.

CHAPTER 18

Basel-III Framework on Liquidity Standards

Oct/Nov 2014

1. What is the prescribed facility rate for the funds availed under the Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR)?
(A) Equal to the prevailing LAF repo rate
(B) 100 bps above the prevailing Marginal Standing Facility (MSF) rate
(C) 50 bps below the prevailing bank rate
(D) 200 bps above the prevailing LAF repo rate

May/June 2007

2. Which statement is incorrect regarding the Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR)?
(A) It can be availed or rolled over up to a maximum period of 90 days.
(B) The facility rate is 200 bps above the prevailing LAF repo rate.
(C) Banks can avail this facility immediately without exhausting other HQLAs first.
(D) Liquidity against securities under FALLCR is available after applying haircuts as stipulated for MSF.

Oct/Nov 2023

3. Under the Net Stable Funding Ratio (NSFR) framework, what does “Required Stable Funding” (RSF) represent?
(A) The minimum capital conservation buffer a bank must hold to absorb potential credit losses.
(B) Total value of retail deposits unlikely to run off during a specific 30-day stress period.
(C) A function of liquidity and maturity of assets plus off-balance sheet exposures.
(D) Government securities mandated under the specific Statutory Liquidity Ratio (SLR).

May/June 2019

4. Which of the following is NOT considered a fundamental characteristic of High-Quality Liquid Assets (HQLAs)?

- (A) Ease and certainty of valuation
- (B) Low correlation with risky assets
- (C) Presence of committed market makers
- (D) Low credit and market risk

Oct/Nov 2006

5. What is the conceptual rationale for the “LCR by Significant Currency” monitoring tool?
(A) To prevent banks from holding foreign currencies that are subject to high volatility.
(B) To capture potential currency mismatches, since the primary LCR standard is required to be met in one single currency.
(C) To mandate that banks hold all their HQLA exclusively in their domestic currency.
(D) To ensure that banks do not engage in international trade finance without adequate capital backing.

May/June 2021

6. What is the most appropriate regulatory expectation if a bank’s stock of HQLA falls below the 100% minimum LCR requirement during a period of financial stress?
(A) The bank must immediately cease all lending operations and liquidate all Level 2B assets.
(B) Use of HQLA is permitted provided the bank reports usage reasons and corrective actions.
(C) The bank is automatically placed under Prompt Corrective Action regardless of its CAR.
(D) The bank must convert its operational deposits into equity to replenish the HQLA shortfall.

Oct/Nov 2010

7. How is the Liquidity Coverage Ratio (LCR) defined under the Basel III framework?
(A) The ratio of total liquid assets to total liabilities measured over a 90-day period.

encourage variety.

- (D) To ensure that the bank meets its LCR requirements uniformly across all its traded currencies.

May/June 2020

22. What is the maximum permitted percentage of Level 2B assets in the overall stock of High-Quality Liquid Assets (HQLAs)?

- (A) 40%
(B) 15%
(C) 50%
(D) 85%

Oct/Nov 2015

23. Which of the following combinations conceptually defines the fundamental characteristics of High-Quality Liquid Assets (HQLA)?

- (A) High credit risk, listing on a recognized exchange, and low correlation with risky assets.
(B) Presence of committed market makers, high market concentration, and flight to quality.
(C) High yield potential, complex valuation models, and long-term residual asset maturity.
(D) Low credit risk, ease of valuation, low asset correlation, and listing on recognized markets.

May/June 2013

24. According to the Required Stable Funding (RSF) categories, which of the following does NOT attract a 0% RSF factor?

- (A) Coins and banknotes.
(B) Cash Reserve Ratio (CRR) including excess CRR.
(C) "Trade date" receivables arising from sales of financial instruments, foreign currencies, and commodities.
(D) Unencumbered Level 2A assets.

Oct/Nov 2021

25. Which of the following statements regarding the weaknesses of Basel II and improvements in Basel III is incorrect?

- (A) Basel II permitted excessive discretion to financial institutions for computing crucial parameters like risk weights.
(B) Basel III allows unrestricted use of complex models for calculating risk weights across

all categories of asset classes.

- (C) Basel III mandated a higher capital adequacy ratio including the addition of capital conservation buffers.
(D) Basel III introduced minimum "floor" values used to calculate specific risk weights for Credit Risk.

May/June 2024

26. Which of the following best defines the "Contractual Maturity Mismatch" monitoring tool?

- (A) Identifies funding sources significant enough that their withdrawal triggers liquidity problems.
(B) Captures the quantity and characteristics of a bank's total available unencumbered assets.
(C) Provides high-frequency market data that serves as an early warning for liquidity difficulties.
(D) Identifies liquidity gaps between inflows and outflows across time bands to gauge funding needs.

Oct/Nov 2008

27. What was the most appropriate reason for the Basel Committee to introduce minimum "floor" values to calculate risk weights under the Standardised Approach for Credit Risk?

- (A) To limit bank discretion in reducing risk-weight variability via complex internal models.
(B) To simplify the standard accounting procedures required for commercial bank audit cycles.
(C) To increase the overall profitability of retail banking operations on a global scale.
(D) To ensure that all government securities are explicitly excluded from risk computations.

May/June 2006

28. How do the objectives of the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) differ conceptually?

- (A) LCR targets 30-day stress resilience; NSFR targets stable funding over the long term.
(B) LCR promotes medium-term resilience; NSFR prevents bank runs within a one-year horizon.
(C) LCR addresses credit and market risks; NSFR specifically addresses operational

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- (B) The minimum CAR was reduced from 11.50% to 9% to promote credit growth and stimulate domestic economic activity.
- (C) First trigger at 11.50% (restricts profit); second at 9% (triggers corrective action).
- (D) The Supervisor invokes the 'Narrow Banking' concept immediately upon CAR dropping below the 11.50% threshold limit.

Oct/Nov 2019

15. Which statement provides the most appropriate description of the primary objective of the Net Stable Funding Ratio (NSFR)?
- (A) To ensure banks survive a severe 30-day liquidity stress scenario by liquidating HQLAs.
 - (B) To constrain the build-up of off-balance sheet leverage during various economic booms.
 - (C) To provide supervisors with data on the quantity and characteristics of unencumbered assets.
 - (D) To ensure stable funding relative to assets and off-balance sheet activities over one year.

May/June 2009

16. What is the definition of "Available Stable Funding" (ASF) in the context of the Net Stable Funding Ratio?
- (A) Capital/liabilities expected to be reliable over the NSFR time horizon of one year.
 - (B) High-quality liquid assets expected to be easily converted to cash within 30 days.
 - (C) Total regulatory capital excluding Tier 2 instruments with short residual maturity.
 - (D) Stable funding required based on liquidity characteristics of various bank assets.

Oct/Nov 2011

17. The Basel III framework prescribes monitoring tools/metrics for better monitoring a bank's liquidity position. Which of the following is NOT one of these prescribed tools?
- (A) Net Stable Funding Overreliance
 - (B) Contractual Maturity Mismatch
 - (C) Concentration of Funding
 - (D) Market-related Monitoring Tools

May/June 2010

18. What is the specific haircut applied to Level 2A assets when converting them into cash for inclusion in the stock of HQLAs?
- (A) 15%
 - (B) 0%
 - (C) 35%
 - (D) 50%

Oct/Nov 2024

19. Which of the following statements about Basel III Liquidity Returns is incorrect?
- (A) Statement on Funding Concentration (BLR-2) is to be submitted Monthly within 15 days.
 - (B) Statement of Available Unencumbered Assets (BLR-3) is to be submitted Quarterly within 15 days.
 - (C) Statement on LCR by Significant Currency (BLR-4) is to be submitted Monthly within 15 days.
 - (D) Statement on Liquidity Coverage Ratio (BLR-1) is to be submitted Quarterly within 15 days.

May/June 2017

20. Which statement correctly identifies the applicability of the Net Stable Funding Ratio (NSFR) for foreign banks operating as branches in India?
- (A) The framework is applicable on a stand-alone basis for Indian operations only.
 - (B) The framework is applicable at the consolidated level of their global operations.
 - (C) Foreign branches are entirely exempt from NSFR requirements.
 - (D) Foreign branches must adhere to the NSFR rules of their home country regulators exclusively.

Oct/Nov 2005

21. What is the most appropriate reason for implementing "Concentration of Funding" as a liquidity risk monitoring tool?
- (A) To evaluate the total duration of trade finance-related obligations across the institution.
 - (B) To calculate the specific haircut required on unencumbered Level 2A assets held by banks.
 - (C) To identify funding sources whose withdrawal triggers liquidity issues to

- IV. Domestic banks must endeavour to meet the standard at the consolidated level, while foreign banks operate on a stand-alone basis locally.
- V. Due to the pandemic, regulators permanently reduced the LCR requirement to 90% from April 1, 2021 onwards.

Which of the following combinations of statements is correct?

- (A) I, II, III, and IV only
(B) I, II, IV, and V only
(C) II, III, IV, and V only
(D) I, III, IV, and V only

May/June 2009

58. Which of the following is an INCORRECT pair of a Basel III measure and its description/objective?

- (A) Leverage Ratio — A risk-weighted metric designed to encourage the use of advanced internal models.
- (B) Capital Adequacy Ratio — A standard metric requiring additional capital conservation buffers.
- (C) Liquidity Coverage Ratio — Ensures adequate HQLA for a 30-calendar day time horizon period.
- (D) Net Stable Funding Ratio — Promotes resilience over medium to longer-term time horizons.

Oct/Nov 2011

59. The Basel III framework addressed the limitations of Basel II using several measures. Consider the following statements representing these measures:

- I. Mandating a higher capital adequacy ratio including additional capital conservation buffers.
- II. Reducing the variability of risk-weighted assets by limiting the discretion of banks.
- III. Introducing a non-risk weighted leverage ratio.
- IV. Eliminating the use of High-Quality Liquid Assets to encourage long-term real estate investments.

Which combination of statements correctly represents the measures taken?

- (A) I, II, and III only
(B) II, III, and IV only
(C) I, III, and IV only
(D) I, II, III, and IV

May/June 2010

60. Consider the following statements regarding the “Available Unencumbered Assets” monitoring tool:

- I. It provides supervisors with data on the quantity and key characteristics of a bank’s encumbered assets locked in central bank reserves.
- II. These assets have the potential to be used as collateral to raise additional secured funding in secondary markets.

Which of the above statement(s) is/are correct?

- (A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

Oct/Nov 2024

61. Read the following scenario and answer the question that follows.

Global Trust Bank is computing its Liquidity Coverage Ratio (LCR) to assess its short-term resilience against a severe 30-day stress scenario. The bank calculates its total net cash outflows over the next 30 days to be ₹100,000 crores. Within the HQLA portfolio, the risk manager notices an opportunity to invest heavily in Level 2B assets due to favorable yields. What is the absolute maximum value of Level 2B assets the bank is permitted to include in the overall HQLA stock?

- (A) ₹10,000 crores
(B) ₹40,000 crores
(C) ₹15,000 crores
(D) ₹50,000 crores

May/June 2017

62. Read the following scenario and answer the question that follows.

The regulatory reporting unit of Continental Heritage Bank is preparing its periodic Basel III Liquidity Returns to be submitted to the Central Bank. The unit is currently compiling data for the month of July. The compliance officer must ensure that all returns are submitted within the strict regulatory deadlines to avoid supervisory action. Which Basel III Liquidity Return corresponds to the “Statement of Funding Concentration” prepared by the unit, and what is its required frequency?

- (A) BLR-2, submitted Monthly
(B) BLR-1, submitted Quarterly
(C) BLR-3, submitted Monthly

risks.

- (D) LCR requires loss-absorbing capital; NSFR mandates a leverage ratio limit.

Oct/Nov 2017

29. The stress scenario specified by the Basel Committee entails a combined idiosyncratic and market-wide shock. Which of the following is NOT one of the resulting outcomes of this shock?

- (A) A partial loss of unsecured wholesale funding capacity.
- (B) Additional contractual outflows arising from a downgrade in the bank's public credit rating by up to three notches.
- (C) A mandatory increase in Statutory Liquidity Ratio (SLR) requirements by the central bank.
- (D) The run-off of a proportion of retail deposits.

May/June 2008

30. Which statement correctly describes Level 1 High-Quality Liquid Assets?

- (A) They include cash and near cash equivalents and are subjected to a regulatory 15% valuation haircut.
- (B) They are strictly limited to a maximum of 40% of the overall stock of HQLAs held by the institution.
- (C) They consist exclusively of physical traded commodities, including high-grade gold bullion reserves.
- (D) They include Government securities within the SLR requirement to the extent allowed under MSF/FALLCR.

Oct/Nov 2013

31. Match the Required Stable Funding (RSF) categories in List I with their associated RSF factors in List II.

List I: (RSF Category)

- P. Unencumbered Level 2B assets
- Q. Unencumbered 'standard' residential mortgages (maturity ≥ 1 yr, risk weight $\leq 35\%$)
- R. Cash posted as initial margin for derivative contracts
- S. Physical traded commodities, including gold

List II: (RSF Factor)

- 1. 100%
- 2. 85%

3. 50%

4. 65%

- (A) P-2, Q-4, R-1, S-3
- (B) P-3, Q-4, R-2, S-1
- (C) P-4, Q-3, R-1, S-2
- (D) P-1, Q-2, R-4, S-3

May/June 2015

32. Consider the following statements regarding the Net Stable Funding Ratio (NSFR):

- I. The objective of NSFR is to ensure banks maintain a stable funding profile in relation to their off-balance sheet activities only.
- II. It is defined as the amount of available stable funding relative to the amount of required stable funding.
- III. The ratio must be equal to at least 100% on an ongoing basis.

Which of the following combinations of statements is correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2012

33. Match the Basel III Liquidity Returns in List I with their corresponding names in List II.

List I: (Return Code)

- P. BLR-1
- Q. BLR-2
- R. BLR-3
- S. BLR-4

List II: (Name of the Return)

- 1. Statement of Available Unencumbered Assets
- 2. Statement on Liquidity Coverage Ratio
- 3. LCR by Significant Currency
- 4. Statement of Funding Concentration
- (A) P-2, Q-4, R-1, S-3
- (B) P-4, Q-2, R-3, S-1
- (C) P-1, Q-3, R-2, S-4
- (D) P-2, Q-1, R-4, S-3

May/June 2011

34. Consider the following Required Stable Funding (RSF) categories:

- I. Unencumbered Level 2B assets.
- II. Unencumbered 'standard' residential mortgages with residual maturity of one year or more and minimum risk weight permitted under the Standardised Approach.

NODIA

May/June 2019

46. Arrange the minimum LCR requirements in the correct chronological order according to the pandemic relaxation and subsequent reinstatement phases:
- April 1, 2021 onwards
 - October 1, 2020 to March 31, 2021
 - April 17, 2020 to September 30, 2020
- (A) II (90%), I (100%), III (80%)
 (B) III (80%), II (90%), I (100%)
 (C) I (100%), III (80%), II (90%)
 (D) III (60%), II (80%), I (100%)

Oct/Nov 2006

47. Consider the following categories of Available Stable Funding (ASF):
- Total regulatory capital (excluding Tier 2 instruments with residual maturity of less than one year).
 - Stable non-maturity deposits provided by retail customers.
 - NSFR derivative liabilities net of NSFR derivative assets if liabilities are greater than assets.
 - “Trade date” payables arising from purchases of financial instruments.
- Which combination represents items that are assigned a 100% or 0% ASF factor respectively?
- (A) I and II represent 100%; III and IV represent 0%
 (B) I represents 100%; II, III, and IV represent 0%
 (C) I represents 100%; III and IV represent 0%; II represents 95%
 (D) I and III represent 100%; II and IV represent 0%

May/June 2021

48. Which of the following is a correctly matched pair of an Off-balance Sheet Item and its Associated RSF factor?
- Irrevocable and conditionally revocable credit facilities — 50% of the currently undrawn portion
 - Unconditionally revocable credit and liquidity facilities — 5% of the currently undrawn portion
 - Trade finance-related obligations (including guarantees and letters of credit) — 10% of the currently undrawn portion
 - Structured products where customers anticipate ready marketability — 3% of the

currently undrawn portion

Oct/Nov 2010

49. Consider the following statements regarding Market-related Monitoring Tools:
- They include high frequency market data.
 - They serve as early warning indicators in monitoring potential liquidity difficulties at banks.
 - They calculate the contractual maturity mismatches for time bands extending beyond 5 years.
- Which of the following combinations of statements is correct?
- (A) I and II only
 (B) II and III only
 (C) I and III only
 (D) I, II, and III

May/June 2005

50. Consider the following statements regarding LCR Disclosure Standards:
- Banks are required to disclose information on their LCR in their annual financial statements under Notes to Accounts.
 - In subsequent annual financial statements following the initial year, the disclosure should cover all the four quarters of the relevant financial year.
- Which of the above statement(s) is/are correct?
- (A) Only I
 (B) Only II
 (C) Both I and II
 (D) Neither I nor II

Oct/Nov 2022

51. Consider the following statements concerning ASF and RSF computations:
- Carrying value represents the amount at which a liability or equity instrument is recorded before regulatory deductions.
 - Operational deposits are assigned a 50% ASF factor.
 - Unencumbered Level 2A assets are assigned a 15% RSF factor.
 - Unencumbered Level 2B assets are assigned a 25% RSF factor.
 - NSFR limits overreliance on short-term wholesale funding.
- Which of the following combinations of statements is correct?
- (A) I, II, III, and V only

- (B) Level 2A Assets — 50% haircut
- (C) Level 2 Assets Overall — 0% haircut
- (D) Level 2B Assets — 50% haircut

Oct/Nov 2025

41. Consider the following statements regarding off-balance sheet items and liquidity returns:
- I. Irrevocable and conditionally revocable credit facilities attract a 5% RSF factor of the currently undrawn portion.
 - II. Unconditionally revocable credit facilities attract a 5% RSF factor of the currently undrawn portion.
 - III. Trade finance-related obligations attract a 3% RSF factor of the currently undrawn portion.
 - IV. The Statement on LCR (BLR-1) must be submitted Quarterly.
 - V. The Statement of Available Unencumbered Assets (BLR-3) must be submitted Quarterly within 15 days.

Which of the following combinations of statements is correct?

- (A) I, II, III, and V only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, IV, and V only

May/June 2016

42. Match the Available Stable Funding (ASF) categories in List I with their associated ASF factors in List II.

List I: (ASF Category)

- P. Total regulatory capital (residual maturity ≥ 1 yr)
- Q. Stable non-maturity deposits provided by retail customers
- R. Less stable non-maturity deposits provided by retail customers
- S. Funding with residual maturity < 1 yr provided by non-financial corporate customers

List II: (ASF Factor)

- 1. 95%
- 2. 50%
- 3. 100%
- 4. 90%
- (A) P-3, Q-1, R-4, S-2
- (B) P-1, Q-2, R-3, S-4
- (C) P-4, Q-3, R-2, S-1
- (D) P-3, Q-4, R-1, S-2

Oct/Nov 2014

43. Consider the following statements regarding the Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR):
- I. Availing of liquidity against securities under FALLCR is permitted only after the utilization of all other HQLAs.
 - II. The facility can be availed or rolled over up to a maximum period of 180 days.
 - III. Banks are required to furnish a declaration that they have exhausted all other HQLAs before availing FALLCR.
- Which of the following combinations of statements is correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2007

44. Consider the following statements regarding the scope of LCR:
- I. The LCR framework is applicable to domestic banks strictly on a consolidated basis only, excluding stand-alone operations.
 - II. For foreign banks operating as branches, the LCR framework is applicable on a stand-alone basis for local operations only.
- Which of the above statement(s) is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2023

45. The Basel III framework prescribes monitoring tools for a bank's liquidity position. Consider the following tools:
- I. Contractual Maturity Mismatch
 - II. Concentration of Funding
 - III. Available Unencumbered Assets
 - IV. LCR by Significant Currency
 - V. Market-related Monitoring Tools
- Which combination represents the formally prescribed monitoring tools?
- (A) I, II, III, and V only
 - (B) I, II, IV, and V only
 - (C) I, III, IV, and V only
 - (D) I, II, III, IV, and V

NODIA

III. Cash posted as initial margin for derivative contracts.

IV. Physical traded commodities, including gold.

Which combination assigns the correct RSF factors to all the above items?

(A) I: 50%, II: 65%, III: 85%, IV: 100%

(B) I: 65%, II: 50%, III: 100%, IV: 85%

(C) I: 50%, II: 85%, III: 65%, IV: 100%

(D) I: 85%, II: 65%, III: 100%, IV: 50%

Oct/Nov 2020

35. Consider the following statements regarding the regulatory initiatives for LCR:

I. Regulators may permit banks to avail funds under liquidity facilities by dipping into the mandatory liquidity requirements cumulatively up to a specific percentage of NDTL to meet LCR requirements.

II. This facility dispensation qualifies as high-quality liquid assets (HQLA) for the calculation of LCR.

Which of the above statement(s) is/are correct?

(A) Only I

(B) Only II

(C) Both I and II

(D) Neither I nor II

May/June 2022

36. Consider the following statements about the Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR):

I. It permits banks to avail liquidity against specific securities under stress conditions.

II. The facility can be availed for a maximum period of 90 days.

III. Haircuts applied are the same as those stipulated for standard marginal standing facilities.

IV. The facility rate is 200 bps above the prevailing repo rate.

V. Securities reckoned under this facility are limited to government securities outside the mandatory statutory liquidity requirements.

Which of the following combinations of statements is correct?

(A) I, II, III, and IV only

(B) I, II, III, and V only

(C) II, III, IV, and V only

(D) I, III, IV, and V only

Oct/Nov 2009

37. Arrange the minimum LCR requirement percentages in the correct chronological order as they were phased in on January 1 of the years 2015, 2016, 2017, and 2018 respectively.

(A) 60%, 70%, 80%, 90%

(B) 50%, 60%, 75%, 90%

(C) 60%, 80%, 90%, 100%

(D) 70%, 80%, 90%, 100%

May/June 2023

38. Consider the following statements concerning the transition from Basel II to Basel III:

I. Global financial crises highlighted the inadequacy of Basel II norms.

II. Examples of bank failures demonstrated how banks could underestimate their risk weights by using complex models under Basel II.

III. Basel III eliminated the Capital Adequacy Ratio entirely in favor of the Leverage Ratio.

Which of the following combinations of statements is correct?

(A) I and II only

(B) II and III only

(C) I and III only

(D) I, II, and III

Oct/Nov 2018

39. The stress scenario specified for the LCR entails multiple liquidity pressures. Consider the following outcomes:

I. The run-off of a proportion of retail deposits.

II. Increases in market volatilities that require larger collateral haircuts.

III. Unscheduled draws on committed but unused credit and liquidity facilities.

IV. A complete suspension of the Statutory Liquidity Ratio (SLR) by the regulator.

Which combination of statements correctly identifies the outcomes of the prescribed stress scenario?

(A) I, II, and IV only

(B) I, III, and IV only

(C) I, II, and III only

(D) II, III, and IV only

May/June 2012

40. Which of the following is a correctly matched pair regarding the HQLA classification and its associated haircut?

(A) Level 1 Assets — 15% haircut

- (B) I, II, III, and IV only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

May/June 2018

52. Match the Required Stable Funding (RSF) categories in List I with their associated RSF factors in List II.

List I: (RSF Category)

- P. Coins and banknotes
- Q. Unencumbered Level 2A assets
- R. Unencumbered loans to financial institutions with residual maturity < 6 months secured against Level 1 assets
- S. Unencumbered Level 2B assets

List II: (RSF Factor)

- 1. 15%
- 2. 50%
- 3. 0%
- 4. 10%
- (A) P-1, Q-3, R-4, S-2
- (B) P-3, Q-1, R-4, S-2
- (C) P-3, Q-4, R-1, S-2
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2016

53. Which of the following is an INCORRECT pair of an Available Stable Funding (ASF) category and its associated ASF factor?
- (A) Other liabilities with effective residual maturity of one year or more — 100%
 - (B) Stable non-maturity deposits provided by retail customers — 95%
 - (C) Funding with residual maturity of less than one year provided by non-financial corporate customers — 90%
 - (D) All other liabilities and equity not included in specific categories (without a stated maturity) — 0%

May/June 2014

54. Consider the following characteristics related to liquid assets:
- I. Low credit and market risk.
 - II. Low correlation with risky assets.
 - III. Listing on a developed and recognized exchange market.
 - IV. High market concentration leading to restricted trading volumes.
- Which combination of statements accurately represents the fundamental and market characteristics of HQLAs?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, II, and IV only
- (D) I, III, and IV only

Oct/Nov 2007

55. Consider the following statements regarding Level 2 assets under the LCR framework:

- I. Level 2 assets comprise Level 2A and Level 2B assets.
- II. Level 2 assets can comprise no more than 40% of the overall stock of HQLAs after haircuts have been applied.
- III. The portfolio of Level 2 assets held by a bank must be concentrated in a single specific counterparty to ensure ease of valuation.

Which of the following combinations of statements is correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2025

56. Match the following metrics/standards in List I with their specific properties in List II.

List I: (Metric/Standard)

- P. Level 2A assets haircut
- Q. Level 2B assets maximum cap
- R. FALLCR maximum tenor
- S. Minimum LCR starting Jan 1, 2018

List II: (Value/Property)

- 1. 15%
- 2. 90 days
- 3. 90%
- 4. 15% of total stock of HQLA
- (A) P-4, Q-2, R-3, S-1
- (B) P-1, Q-4, R-2, S-3
- (C) P-2, Q-1, R-4, S-3
- (D) P-3, Q-4, R-1, S-2

Oct/Nov 2019

57. Consider the following statements regarding the Liquidity Coverage Ratio (LCR):

- I. LCR ensures banks have sufficient HQLAs to survive an acute stress scenario lasting for 30 days.
- II. The denominator of the LCR formula is the Total Net Cash Outflows over the next 30 calendar days.
- III. The LCR standard was originally mandated to reach 100% by January 1, 2019.

- (B) HQLA stock divided by Total Net Cash Outflows over the next 30 calendar days.
- (C) The total available stable funding relative to the required stable funding requirements.
- (D) The proportion of core deposits relative to the total risk-weighted bank assets.

May/June 2005

8. Which of the following statements correctly identifies an element of the stress scenario specified for the Liquidity Coverage Ratio (LCR)?
- (A) A complete loss of all retail and wholesale deposits simultaneously.
 - (B) Unscheduled draws on committed but unused credit and liquidity facilities provided to clients.
 - (C) A full loss of secured, short-term financing with all counter parties.
 - (D) An upgrade in the bank's public credit rating resulting in reduced collateral requirements.

Oct/Nov 2022

9. According to the computation of Available Stable Funding (ASF), which of the following is NOT included in the 100% ASF factor category?
- (A) Total regulatory capital excluding Tier 2 instruments with residual maturity of less than one year.
 - (B) Stable non-maturity (demand) deposits provided by retail and small business customers.
 - (C) Other capital instruments with effective residual maturity of one year or more.
 - (D) Other liabilities with effective residual maturity of one year or more.

May/June 2018

10. What was the primary objective behind the introduction of the leverage ratio by the Basel Committee on Banking Supervision (BCBS)?
- (A) To replace the risk-based capital adequacy ratio with a pure asset-based regulatory measure.
 - (B) To ensure banks maintain adequate unencumbered HQLAs that can be easily converted into cash.
 - (C) To limit sector leverage and support risk-based requirements with a non-risk backstop measure.
 - (D) To reduce risk-weighted asset variability by permitting use of advanced internal bank

models.

Oct/Nov 2016

11. In the computation of the Net Stable Funding Ratio, what is the most appropriate definition of "carrying value" of an institution's capital and liabilities?
- (A) The forecasted market value of a specific liability one year from the current report date.
 - (B) The nominal value of an asset multiplied by its associated required stable funding factor.
 - (C) The value derived after applying the standard Basel III haircuts for specific liabilities.
 - (D) The recorded value of a liability or equity before regulatory deductions and adjustments.

May/June 2014

12. What was the minimum LCR requirement mandated for banks starting from January 1, 2019?
- (A) 60%
 - (B) 80%
 - (C) 100%
 - (D) 90%

Oct/Nov 2007

13. Which statement regarding the Liquidity Coverage Ratio (LCR) is incorrect?
- (A) During a period of financial stress, banks are strictly prohibited from using their stock of HQLA if it causes the LCR to fall below 100%.
 - (B) The LCR requirement was binding on banks starting from January 1, 2015.
 - (C) The minimum LCR requirement was gradually phased in, starting at 60% for the calendar year 2015.
 - (D) Due to the pandemic, central bank authorities temporarily relaxed the maintenance of LCR to 80% for the period April 17, 2020, to September 30, 2020.

May/June 2025

14. Which of the following statements correctly describes the Basel III triggers for the Capital Adequacy Ratio (CAR) in India?
- (A) The first trigger is breached when CAR falls below 9%, bringing the bank under Prompt Corrective Action oversight.

(D) BLR-4, submitted Quarterly

Oct/Nov 2005

63. Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason (R). Select the correct answer from the options provided.

Assertion (A): Level 2B assets can comprise a maximum of 40% of the overall stock of High-Quality Liquid Assets (HQLA) after haircuts.

Reason (R): Level 2 assets as a whole (comprising Level 2A and Level 2B) are capped at 40% of the overall stock of HQLOs.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

64. Read the following scenario and answer the question that follows.

City Vanguard Bank is calculating its Net Stable Funding Ratio (NSFR) as of March 31. The ALM (Asset Liability Management) desk has gathered the carrying values of liabilities to compute the Available Stable Funding (ASF). The portfolio includes ₹50,000 crores of Tier 1 regulatory capital, ₹30,000 crores in stable retail demand deposits, ₹20,000 crores of operational deposits, and ₹10,000 crores of "Trade date" payables arising from commodity purchases. What ASF factor should City Vanguard Bank apply to the ₹50,000 crores of Tier 1 regulatory capital?

- (A) 100%
- (B) 50%
- (C) 90%
- (D) 95%

Oct/Nov 2015

65. Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason (R). Select the correct answer from the options provided.

Assertion (A): Under Basel III, a simple, transparent, non-risk-based leverage ratio has been introduced.

Reason (R): During the global financial crisis, banks built up excessive leverage while

apparently maintaining strong risk-based capital ratios by exploiting the risk weight function.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2013

66. Read the following scenario and answer the question that follows.

Apex Commercial Bank is completing its Required Stable Funding (RSF) calculations. The bank's asset portfolio contains diverse categories, including ₹5,000 crores in coins and banknotes, ₹12,000 crores of unencumbered Level 2A assets, ₹8,000 crores of physical traded gold, and ₹15,000 crores of off-balance sheet unconditionally revocable credit facilities provided to corporate clients. For the ₹12,000 crores of unencumbered Level 2A assets, what amount of Required Stable Funding will this asset category generate?

- (A) ₹600 crores
- (B) ₹1,800 crores
- (C) ₹1,200 crores
- (D) ₹6,000 crores

Oct/Nov 2021

67. Read the following scenario and answer the question that follows.

National Mercantile Bank experiences an unexpected idiosyncratic liquidity shock combined with severe market-wide volatility. The bank has completely exhausted its Level 1, Level 2A, and Level 2B HQLAs, including the securities permitted under standard liquidity facilities. Facing immediate outflows, the bank's treasury department decides to utilize the 'Facility to Avail Liquidity for Liquidity Coverage Ratio' (FALLCR) from the Central Bank to maintain its survival over the stress period. Before the bank can successfully avail funds under FALLCR, which of the following procedural conditions must the treasury department fulfill?

- (A) Liquidate all fixed assets with residual maturity over one year.
- (B) Reduce its core capital conservation buffer to 9%.
- (C) Furnish a declaration stating that the bank

day-to-day liquidity and ensuring that sufficient funds are available.

27. (A) To limit bank discretion in reducing risk-weight variability via complex internal models. The introduction of minimum floor values for risk weights under the Standardised Approach aims to enhance the consistency of capital requirements across the banking industry. By limiting the extent to which banks can reduce their risk-weighted assets using internal models, the regulator ensures a more robust capital base. This addresses the problem of underestimating risks during previous crises.
28. (A) LCR targets 30-day stress resilience; NSFR targets stable funding over the long term. The Liquidity Coverage Ratio and the Net Stable Funding Ratio are complementary standards with different temporal focuses. The LCR is designed to ensure short-term resilience by requiring banks to hold enough high-quality liquid assets to survive a thirty-day stress scenario. In contrast, the NSFR focuses on a one-year horizon, ensuring that long-term assets are funded with stable sources.
29. (C) A mandatory increase in Statutory Liquidity Ratio (SLR) requirements by the central bank. The LCR stress scenario simulates a combination of idiosyncratic and market-wide shocks. It includes the runoff of retail deposits, loss of wholesale funding, and additional outflows from credit rating downgrades. However, a mandatory increase in the Statutory Liquidity Ratio by the regulator is not an assumption of the stress test; rather, SLR assets are often used to meet requirements.
30. (D) They include Government securities within the SLR requirement to the extent allowed under MSF/FALLCR. Level 1 High-Quality Liquid Assets consist of the most liquid assets, such as cash and certain government securities. In the Indian context, government securities held within the Statutory Liquidity Ratio are included in Level 1 HQLA to the extent allowed under specific facilities like the Marginal Standing Facility and the Facility to Avail Liquidity for Liquidity Coverage Ratio.

31. (B) P-3, Q-4, R-2, S-1
Under NSFR, different asset classes attract specific Required Stable Funding factors. Unencumbered Level 2B assets are assigned a fifty percent factor. Standard residential mortgages with a maturity over one year and low risk weight attract a sixty-five percent factor. Cash posted as initial margin for derivatives is assigned eighty-five percent, while physical traded commodities like gold require full funding.
32. (B) II and III only
The Net Stable Funding Ratio is defined as the amount of Available Stable Funding relative to Required Stable Funding. Banks are required to maintain an NSFR of at least one hundred percent on an ongoing basis. While the ratio considers off-balance sheet activities, its primary objective is to ensure a stable funding profile for all assets and activities.
33. (A) P-2, Q-4, R-1, S-3
The regulatory reporting framework uses specific codes for liquidity returns. BLR-1 is the Statement on Liquidity Coverage Ratio. BLR-2 refers to the Statement of Funding Concentration. BLR-3 is used for the Statement of Available Unencumbered Assets. Finally, BLR-4 is the report for LCR by Significant Currency. These returns provide supervisors with comprehensive data to monitor bank liquidity.
34. (A) I: 50%, II: 65%, III: 85%, IV: 100%
The Required Stable Funding factors for assets depend on their liquidity. Unencumbered Level 2B assets carry a fifty percent factor. Standard residential mortgages with maturities exceeding one year are assigned a sixty-five percent factor. Cash used as initial margin for derivative contracts attracts an eighty-five percent factor, while physical commodities like gold require full stable funding support.
35. (C) Both I and II
Regulators allow banks to meet their Liquidity Coverage Ratio requirements by utilizing certain portions of their mandatory liquidity holdings. Banks can avail funds through specific facilities by dipping into their Statutory Liquidity Ratio up to a prescribed percentage of their Net Demand and Time Liabilities. This dispensation is

Oct/Nov 2013

73. Read the following scenario and answer the question that follows.

The regulatory reporting unit of Continental Heritage Bank is preparing its periodic Basel III Liquidity Returns to be submitted to the Central Bank. The unit is currently compiling data for the month of July. The compliance officer must ensure that all returns are submitted within the strict regulatory deadlines to avoid supervisory action. The unit also completed the Statement of Available Unencumbered Assets (BLR-3). What is the correct submission frequency and deadline for this specific return?

- (A) Monthly, within 15 days
- (B) Quarterly, within 15 days
- (C) Monthly, within a month
- (D) Annually, within 15 days

May/June 2015

74. Read the following scenario and answer the question that follows.

Apex Commercial Bank is completing its Required Stable Funding (RSF) calculations. The bank's asset portfolio contains diverse categories, including ₹5,000 crores in coins and banknotes, ₹12,000 crores of unencumbered Level 2A assets, ₹8,000 crores of physical traded gold, and ₹15,000 crores of off-balance sheet unconditionally revocable credit facilities provided to corporate clients. What RSF factor is applicable to the ₹5,000 crores held in coins and banknotes?

- (A) 5%
- (B) 15%
- (C) 100%
- (D) 0%

Oct/Nov 2012

75. Read the following scenario and answer the question that follows.

Global Trust Bank is computing its Liquidity Coverage Ratio (LCR) to assess its short-term resilience against a severe 30-day stress scenario. The bank calculates its total net cash outflows over the next 30 days to be ₹100,000 crores. The risk management committee is evaluating the composition of the High-Quality Liquid Assets (HQLA) to ensure regulatory compliance regarding limits on different asset levels before applying required haircuts. The total adjusted stock of HQLA is intended to exactly equal the net cash outflows. What is the maximum permissible

value of Level 2 assets (Level 2A + Level 2B) the bank can hold in its HQLA portfolio?

- (A) ₹40,000 crores
- (B) ₹15,000 crores
- (C) ₹50,000 crores
- (D) ₹85,000 crores

May/June 2011

76. Read the following scenario and answer the question that follows.

National Mercantile Bank experiences an unexpected idiosyncratic liquidity shock combined with severe market-wide volatility. The bank has completely exhausted its Level 1, Level 2A, and Level 2B HQLAs, including the securities permitted under standard liquidity facilities. Facing immediate outflows, the bank's treasury department decides to utilize the 'Facility to Avail Liquidity for Liquidity Coverage Ratio' (FALLCR) from the Central Bank to maintain its survival over the stress period. What is the maximum duration for which National Mercantile Bank can avail or roll over the funds obtained through the FALLCR?

- (A) 15 days
- (B) 30 days
- (C) 1 year
- (D) 90 days

Oct/Nov 2020

77. Read the following scenario and answer the question that follows.

Apex Commercial Bank is completing its Required Stable Funding (RSF) calculations. The bank's asset portfolio contains diverse categories, including ₹5,000 crores in coins and banknotes, ₹12,000 crores of unencumbered Level 2A assets, ₹8,000 crores of physical traded gold, and ₹15,000 crores of off-balance sheet unconditionally revocable credit facilities provided to corporate clients. What percentage of the currently undrawn portion of the ₹15,000 crores off-balance sheet unconditionally revocable credit facilities will be added to the RSF?

- (A) 3%
- (B) 10%
- (C) 5%
- (D) 50%

May/June 2022

78. Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason

has exhausted all its other HQLAs.

- (D) Convert its tier 2 capital instruments into liquid cash immediately.

May/June 2024

68. Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason (R). Select the correct answer from the options provided.

Assertion (A): Balances held as Cash Reserve Ratio (CRR) including excess CRR are assigned an RSF factor of 0%.

Reason (R): CRR balances represent central bank claims with high liquidity risk profile requiring maximum stable funding support.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2008

69. Read the following scenario and answer the question that follows.

The regulatory reporting unit of Continental Heritage Bank is preparing its periodic Basel III Liquidity Returns to be submitted to the Central Bank. The unit is currently compiling data for the month of July. The compliance officer must ensure that all returns are submitted within the strict regulatory deadlines to avoid supervisory action. For the Statement on Liquidity Coverage Ratio (BLR-1) prepared for the month of July, by when must the regulatory reporting unit submit this return?

- (A) Within a month of the reporting month
 (B) Quarterly within a month
 (C) Annually within 30 days
 (D) Within 15 days of the reporting month

May/June 2006

70. Read the following scenario and answer the question that follows.

City Vanguard Bank is calculating its Net Stable Funding Ratio (NSFR) as of March 31. The ALM (Asset Liability Management) desk has gathered the carrying values of liabilities to compute the Available Stable Funding (ASF). The portfolio includes ₹50,000 crores of Tier 1 regulatory

capital, ₹30,000 crores in stable retail demand deposits, ₹20,000 crores of operational deposits, and ₹10,000 crores of "Trade date" payables arising from commodity purchases. To calculate the stable funding available from the ₹30,000 crores of stable retail demand deposits, what value will be added to the total ASF?

- (A) ₹15,000 crores
 (B) ₹27,000 crores
 (C) ₹28,500 crores
 (D) ₹30,000 crores

Oct/Nov 2017

71. Given below are two statements, one labelled as Assertion (A) and the other labelled as Reason (R). Select the correct answer from the options provided.

Assertion (A): The Liquidity Coverage Ratio (LCR) promotes the resilience of banks over medium to longer-term time horizons.

Reason (R): LCR ensures that banks have sufficient high-quality liquid assets (HQLAs) to survive an acute stress scenario lasting for 30 days.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

May/June 2008

72. Read the following scenario and answer the question that follows.

Global Trust Bank is computing its Liquidity Coverage Ratio (LCR) to assess its short-term resilience against a severe 30-day stress scenario. The bank calculates its total net cash outflows over the next 30 days to be ₹100,000 crores. If the bank holds ₹10,000 crores of Level 2A assets (pre-haircut), what will be their value included in the HQLA computation after applying the regulatory haircut?

- (A) ₹5,000 crores
 (B) ₹10,000 crores
 (C) ₹11,500 crores
 (D) ₹8,500 crores

ANSWERS

1. (D) 200 bps above the prevailing LAF repo rate
The Facility to Avail Liquidity for Liquidity Coverage Ratio provides a liquidity window for banks during stress. The interest rate charged for funds availed under this facility is set at a spread of 200 basis points above the prevailing Liquidity Adjustment Facility repo rate. This ensures the facility acts as a high-cost contingency measure for financial institutions.
2. (C) Banks can avail this facility immediately without exhausting other HQLAs first.
Banks must utilize their existing stock of High-Quality Liquid Assets before accessing the Facility to Avail Liquidity for Liquidity Coverage Ratio. This specific requirement ensures that the facility serves as a lender of last resort mechanism. Banks are required to furnish a formal declaration confirming that all other available liquid assets have been fully exhausted before seeking funds.
3. (C) A function of liquidity and maturity of assets plus off-balance sheet exposures.
Under the Net Stable Funding Ratio framework, Required Stable Funding represents the amount of stable funding an institution is required to hold. This value is calculated based on the broad liquidity characteristics and residual maturities of the various assets held by the bank. It also incorporates the potential liquidity demands arising from specific off-balance sheet contingent exposures and obligations.
4. (C) Presence of committed market makers
High-Quality Liquid Assets must possess fundamental characteristics such as low credit and market risk, ease and certainty of valuation, and low correlation with risky assets. Market-related characteristics include being listed on developed exchanges and having active, sizeable markets. However, the presence of committed market makers is not a mandatory fundamental characteristic for these assets under the Basel framework.
5. (B) To capture potential currency mismatches, since the primary LCR standard is required to be met in one single currency.
Monitoring the Liquidity Coverage Ratio by significant currency allows regulators and banks to identify potential liquidity mismatches across different denominations. Although the aggregate LCR requirement is usually met in a single currency, significant dependencies on foreign currencies can create vulnerabilities. This tool ensures that liquid assets are available in the specific currencies where cash outflows are realistically expected.
6. (B) Use of HQLA is permitted provided the bank reports usage reasons and corrective actions.
During periods of financial stress, banks are allowed to use their stock of High-Quality Liquid Assets, even if this causes the Liquidity Coverage Ratio to drop below the minimum one hundred percent requirement. However, the bank must immediately notify the regulator, providing the specific reasons for the shortfall and a plan for restoring the required liquidity level.
7. (B) HQLA stock divided by Total Net Cash Outflows over the next 30 calendar days.
The Liquidity Coverage Ratio is a fundamental Basel III standard designed to ensure that a bank maintains an adequate level of unencumbered High-Quality Liquid Assets. These assets must be sufficient to cover the total net cash outflows that the bank would encounter under a significant stress scenario lasting for thirty consecutive calendar days to ensure short-term survival.
8. (B) Unscheduled draws on committed but unused credit and liquidity facilities provided to clients.
The stress scenario for calculating the Liquidity Coverage Ratio assumes several liquidity pressures, including the runoff of retail deposits and losses of unsecured wholesale funding. It specifically includes the impact of unexpected or unscheduled draws by customers on committed but currently unused credit and liquidity facilities. This ensures the bank is prepared for sudden increases in cash outflows.

45. (D) I, II, III, IV, and V

The Basel III framework for liquidity risk management prescribes five essential monitoring tools. These include analyzing Contractual Maturity Mismatches, tracking Concentration of Funding from specific sources, monitoring Available Unencumbered Assets for potential collateral use, evaluating LCR by Significant Currency for mismatches, and using Market-related Monitoring Tools as early warning signals for potential liquidity stress at an institution.

46. (B) III (80%), II (90%), I (100%)

Due to the pandemic, the minimum LCR was temporarily reduced to eighty percent from April seventeenth to September thirtieth, twenty-twenty. It was then partially reinstated to ninety percent from October first, twenty-twenty, until March thirty-first, twenty-twenty-one. Finally, the requirement returned to the full one hundred percent level from April first, twenty-twenty-one onwards, reflecting the normalization of conditions.

47. (C) I represents 100%; III and IV represent 0%; II represents 95%

In the Net Stable Funding Ratio calculation, total regulatory capital with a maturity over one year receives a one hundred percent ASF factor. Derivative liabilities and trade date payables are assigned a zero percent factor as they are not reliable sources of stable funding. Stable non-maturity retail deposits are assigned a ninety-five percent factor, reflecting their high, but not absolute, stability.

48. (B) Unconditionally revocable credit and liquidity facilities — 5% of the currently undrawn portion
For off-balance sheet exposures, the RSF factor determines the amount of stable funding needed to cover potential draws. Unconditionally revocable credit and liquidity facilities attract a five percent factor. In contrast, trade finance obligations like letters of credit usually attract a three percent factor. These small percentages reflect the likelihood of these contingent liabilities becoming actual cash outflows.**49. (A) I and II only**

Market-related Monitoring Tools consist of high-frequency data such as stock prices and credit default swap spreads. These tools serve as

valuable early warning indicators for potential liquidity difficulties at a bank. They do not involve calculating contractual maturity mismatches for long-term time bands; that function is specific to the Contractual Maturity Mismatch tool, not to market-based indicators.

50. (C) Both I and II

Banks are mandated to disclose their Liquidity Coverage Ratio in the Notes to Accounts of their annual financial statements. This ensures transparency for stakeholders regarding the bank's liquidity position. After the initial year of disclosure, banks must include data for all four quarters of the relevant financial year, providing a comprehensive view of how liquidity was managed throughout that period.

51. (A) I, II, III, and V only

Carrying value is the recorded amount of a liability before regulatory adjustments. Operational deposits receive a fifty percent ASF factor. Unencumbered Level 2A assets attract a fifteen percent RSF factor. The NSFR framework is specifically designed to limit overreliance on short-term wholesale funding. Statement four is incorrect because unencumbered Level 2B assets are actually assigned a fifty percent RSF factor.

52. (B) P-3, Q-1, R-4, S-2

Cash and banknotes attract a zero percent Required Stable Funding factor. Unencumbered Level 2A assets are assigned a fifteen percent factor. Short-term loans to financial institutions, if secured by Level 1 assets, attract a ten percent RSF factor. Unencumbered Level 2B assets, being less liquid, are assigned a fifty percent factor, requiring more stable funding compared to more liquid assets.

53. (C) Funding with residual maturity of less than one year provided by non-financial corporate customers — 90%

Funding from non-financial corporate customers with a residual maturity of less than one year is typically assigned a fifty percent Available Stable Funding factor, not ninety percent. The ninety percent factor is generally reserved for less stable retail deposits. This reflects the regulatory view that corporate funding is more volatile and less reliable than retail deposits during financial stress.

prescribed monitoring tool within the official regulatory documentation.

18. (A) 15%
High-Quality Liquid Assets are categorized into different levels based on their liquidity profile. Level 1 assets, such as cash and government securities, usually carry no haircut. However, Level 2A assets, which include certain high-quality corporate bonds and specific sovereign debt, are subjected to a minimum fifteen percent haircut when calculating the total stock of available liquid assets for LCR.
19. (D) Statement on Liquidity Coverage Ratio (BLR-1) is to be submitted Quarterly within 15 days. The Statement on Liquidity Coverage Ratio, identified as BLR-1, is a critical regulatory filing. According to the prescribed reporting requirements, this return must be submitted on a monthly frequency within fifteen days of the end of the reporting month. Reporting it on a quarterly basis would be inconsistent with the need for timely monitoring of a bank's short-term liquidity position.
20. (A) The framework is applicable on a stand-alone basis for Indian operations only. For foreign banks operating through branches in India, the Net Stable Funding Ratio framework is applied specifically to their Indian operations on a stand-alone basis. This ensures that the local branch maintains sufficient stable funding to support its activities within the country, independent of the global liquidity position of the parent bank or other international entities.
21. (C) To identify funding sources whose withdrawal triggers liquidity issues to encourage variety. The Concentration of Funding monitoring tool is designed to help banks and supervisors identify significant sources of wholesale funding. By tracking concentrations from specific counterparties or product types, the tool aims to ensure that the withdrawal of a single source does not lead to a liquidity crisis. It encourages banks to maintain a diverse and well-balanced funding base.
22. (B) 15%
Level 2B assets represent the least liquid portion of the High-Quality Liquid Assets permitted under the LCR framework. To ensure the overall portfolio remains highly liquid, regulatory standards impose a cap on these assets. They must not exceed fifteen percent of the total stock of HQLA after the application of the relevant valuation haircuts and necessary adjustments.
23. (D) Low credit risk, ease of valuation, low asset correlation, and listing on recognized markets. High-Quality Liquid Assets are defined by specific fundamental and market-related attributes. Fundamental characteristics include low credit and market risk, ease and certainty of valuation, and low correlation with risky assets. Market-related characteristics require these assets to be traded in active, sizeable markets with low volatility and to be listed on developed and recognized exchange markets.
24. (D) Unencumbered Level 2A assets. Under the Net Stable Funding Ratio, assets that are highly liquid require very little or no stable funding support. Coins, banknotes, and CRR balances are assigned a zero percent Required Stable Funding factor. However, unencumbered Level 2A assets, while liquid, are assigned a fifteen percent RSF factor, reflecting a small requirement for stable funding compared to cash.
25. (B) Basel III allows unrestricted use of complex models for calculating risk weights across all categories of asset classes. One of the primary improvements in Basel III was the reduction of variability in risk-weighted assets. This was achieved by limiting the discretion that banks previously had under Basel II to use complex internal models. Basel III introduced floors and stricter criteria for model usage to ensure that banks do not underestimate their risks and maintain higher capital.
26. (D) Identifies liquidity gaps between inflows and outflows across time bands to gauge funding needs. The Contractual Maturity Mismatch is a monitoring tool that maps a bank's contractual cash inflows and outflows across various time bands. By identifying gaps where outflows exceed inflows, the tool helps the bank and regulators understand potential funding needs at specific future dates. This analysis is crucial for managing

9. (B) Stable non-maturity (demand) deposits provided by retail and small business customers. Available Stable Funding factors represent the reliability of funding sources over a one-year horizon. While total regulatory capital and long-term liabilities with maturities exceeding one year are assigned a one hundred percent factor, stable non-maturity deposits from retail customers are typically assigned a ninety-five percent factor. This reflects the high stability of such deposits without assuming absolute permanence.
10. (C) To limit sector leverage and support risk-based requirements with a non-risk backstop measure.
The Basel Committee introduced the leverage ratio as a non-risk-based backstop to supplement risk-based capital requirements. Its primary purpose is to restrict the excessive build-up of leverage within the banking sector, which was a major factor in the global financial crisis. By using a simple, transparent measure, it mitigates risks associated with complex internal model variability.
11. (D) The recorded value of a liability or equity before regulatory deductions and adjustments.
In the computation of the Net Stable Funding Ratio, the carrying value refers to the amount at which a specific liability or equity instrument is recorded on the balance sheet. This value is used as the base before any regulatory deductions or adjustments are applied. It represents the starting point for calculating Available Stable Funding and Required Stable Funding.
12. (C) 100%
The Liquidity Coverage Ratio requirement was phased in gradually to allow banks sufficient time to adjust their portfolios. Beginning with a minimum of sixty percent in early twenty-fifteen, the requirement increased by ten percentage points each year. On January first, twenty-nineteen, the standard finally reached its full minimum requirement of one hundred percent for all scheduled commercial banks.
13. (A) During a period of financial stress, banks are strictly prohibited from using their stock of HQLA if it causes the LCR to fall below 100%.
Contrary to strict prohibition, the Basel III framework explicitly permits banks to use their

stock of High-Quality Liquid Assets during periods of stress, even if the Liquidity Coverage Ratio drops below the minimum threshold. This flexibility ensures that the liquid assets serve their purpose of meeting unexpected outflows, provided the bank reports the situation to the regulator.

14. (C) First trigger at 11.50% (restricts profit); second at 9% (triggers corrective action).
The regulatory framework for capital adequacy in India includes two critical thresholds. The first trigger occurs at eleven point five percent, which includes the capital conservation buffer; breaching this leads to restrictions on profit distributions. The second trigger is at the minimum regulatory capital requirement of nine percent, which initiates prompt corrective action by the supervisory authorities.
 15. (D) To ensure stable funding relative to assets and off-balance sheet activities over one year.
The Net Stable Funding Ratio aims to promote resilience over a longer time horizon compared to the Liquidity Coverage Ratio. It ensures that banks maintain a reliable funding profile in relation to the composition of their assets and off-balance sheet activities. The standard specifically targets a one-year period to reduce the risk of future funding stress and volatility.
 16. (A) Capital/liabilities expected to be reliable over the NSFR time horizon of one year.
Available Stable Funding is defined as the portion of a bank's capital and liabilities that is expected to be reliable and provide stable funding over a one-year time horizon. This includes regulatory capital, long-term liabilities, and stable deposits. Different categories of funding are assigned specific factors based on their perceived stability and likelihood of remaining with the institution.
- (A) Net Stable Funding Overreliance
The Basel III framework specifies five key monitoring tools for liquidity risk: Contractual Maturity Mismatch, Concentration of Funding, Available Unencumbered Assets, LCR by Significant Currency, and Market-related Monitoring Tools. While the Net Stable Funding Ratio is a core standard, Net Stable Funding Overreliance is not a formally recognized or

recognized as High-Quality Liquid Assets in the official LCR calculations.

36. (A) I, II, III, and IV only

The Facility to Avail Liquidity for Liquidity Coverage Ratio allows banks to access liquidity against government securities within the mandatory SLR requirement. This facility is available for a maximum of ninety days and carries a rate two hundred basis points above the repo rate. Standard haircuts apply. Statement V is incorrect because the facility specifically targets securities within the SLR.

37. (A) 60%, 70%, 80%, 90%

To ensure a smooth transition, the minimum Liquidity Coverage Ratio requirement was implemented in stages. Starting from January first, twenty-fifteen, the requirement began at sixty percent. It then increased by ten percentage points annually, reaching seventy percent in twenty-sixteen, eighty percent in twenty-seventeen, and ninety percent in twenty-eighteen, before finally attaining the full one hundred percent requirement in twenty-nineteen.

38. (A) I and II only

The transition to Basel III was prompted by the global financial crisis, which revealed significant flaws in Basel II. It became evident that banks could underestimate risk weights using complex internal models. While Basel III introduced the leverage ratio as a backstop, it did not eliminate the Capital Adequacy Ratio; instead, it strengthened it with higher requirements and additional buffers.

39. (C) I, II, and III only

The LCR stress scenario includes a runoff of retail deposits, increased market volatility requiring larger collateral haircuts, and unscheduled draws on committed credit facilities. These elements represent realistic liquidity pressures during a crisis. However, the suspension of the Statutory Liquidity Ratio is not an assumed outcome of the stress scenario, as SLR assets are integral to liquid assets.

40. (D) Level 2B Assets — 50% haircut

The LCR framework applies specific haircuts to different classes of High-Quality Liquid Assets to reflect their market liquidity. Level 1 assets

typically have a zero percent haircut. Level 2A assets are subject to a fifteen percent haircut. Level 2B assets, which are generally less liquid than Level 2A, are required to have a much higher haircut of fifty percent.

41. (A) I, II, III, and V only

Irrevocable and unconditionally revocable credit facilities both attract a five percent Required Stable Funding factor for the undrawn portion. Trade finance-related obligations attract a three percent RSF factor. While the BLR-3 return is submitted quarterly, the BLR-1 return for the Liquidity Coverage Ratio is actually required to be submitted monthly, which makes statement four incorrect in this list.

42. (A) P-3, Q-1, R-4, S-2

Total regulatory capital with a maturity over one year is assigned a one hundred percent Available Stable Funding factor. Stable retail non-maturity deposits receive a ninety-five percent factor, while less stable retail deposits get ninety percent. Funding from non-financial corporate customers with a maturity of less than one year is assigned a fifty percent factor, reflecting its moderate stability.

43. (C) I and III only

The Facility to Avail Liquidity for Liquidity Coverage Ratio is a contingency tool. Banks can only use it after they have fully utilized all other available High-Quality Liquid Assets. To access the facility, the bank must provide a formal declaration confirming this exhaustion. The maximum period for availing or rolling over this facility is ninety days, making statement two incorrect.

44. (B) Only II

In India, the Liquidity Coverage Ratio framework is applicable to domestic banks on both a stand-alone and a consolidated basis. However, for foreign banks operating as branches within the country, the framework applies strictly on a stand-alone basis for their Indian operations. This distinction ensures that the local liquidity of foreign bank branches is monitored independently of their global parents.

(R). Select the correct answer from the options provided.

Assertion (A): The Net Stable Funding Ratio (NSFR) limits overreliance on short-term wholesale funding.

Reason (R): NSFR requires banks to fund their activities with more stable sources of funding on an ongoing basis to mitigate the risk of future funding stress.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2016

79. Read the following scenario and answer the question that follows.

National Mercantile Bank experiences an unexpected idiosyncratic liquidity shock combined with severe market-wide volatility. The bank has completely exhausted its Level 1, Level 2A, and Level 2B HQLAs, including the securities permitted under standard liquidity facilities. Facing immediate outflows, the bank's treasury department decides to utilize the 'Facility to Avail Liquidity for Liquidity Coverage Ratio' (FALLCR) from the Central Bank to maintain its survival over the stress period. If the prevailing LAF repo rate is 4.00%, what will be the applicable rate of interest on the funds National Mercantile Bank avails under FALLCR?

- (A) 4.00%
- (B) 6.00%
- (C) 5.00%
- (D) 8.00%

Oct/Nov 2009

80. Read the following scenario and answer the question that follows.

City Vanguard Bank is calculating its Net Stable Funding Ratio (NSFR) as of March 31. The ALM (Asset Liability Management) desk has gathered the carrying values of liabilities to compute the Available Stable Funding (ASF). The portfolio includes ₹50,000 crores of Tier 1 regulatory capital, ₹30,000 crores in stable retail demand deposits, ₹20,000 crores of operational deposits, and ₹10,000 crores of "Trade date" payables

arising from commodity purchases. Which ASF factor must the ALM desk apply to the ₹10,000 crores of "Trade date" payables arising from commodity purchases?

- (A) 0%
- (B) 50%
- (C) 90%
- (D) 100%

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- 54.** (A) I, II, and III only
High-Quality Liquid Assets must have low credit and market risk, ease of valuation, and low correlation with risky assets. They should also be listed on developed and recognized exchange markets. High market concentration is actually a negative trait; HQLAs require diverse markets with high trading volumes and low volatility to ensure they can be liquidated quickly and easily.
- 55.** (A) I and II only
Level 2 assets are divided into categories 2A and 2B. Collectively, these assets cannot exceed forty percent of a bank's total stock of High-Quality Liquid Assets after haircuts. This cap ensures the portfolio is dominated by the most liquid Level 1 assets. The third statement is incorrect because the portfolio must be diversified, not concentrated in a single counterparty.
- 56.** (B) P-1, Q-4, R-2, S-3
Level 2A assets are subject to a fifteen percent haircut. Level 2B assets are capped at fifteen percent of the total HQLA stock. The maximum tenor for funds availed under the Facility to Avail Liquidity for Liquidity Coverage Ratio is ninety days. Finally, as of January first, twenty-eighteen, the minimum required Liquidity Coverage Ratio for banks was ninety percent.
- 57.** (A) I, II, III, and IV only
The Liquidity Coverage Ratio ensures banks can survive a thirty-day stress scenario using high-quality liquid assets. The denominator is the net cash outflow over those thirty days. The standard reached one hundred percent in twenty-nineteen. Domestic banks report consolidated data, while foreign branches report on a stand-alone basis. Statement five is incorrect because the LCR requirement returned to 100%.
- 58.** (A) Leverage Ratio — A risk-weighted metric designed to encourage the use of advanced internal models.
The leverage ratio is specifically defined as a non-risk-based measure, designed to act as a simple backstop to risk-based capital requirements. It does not use risk weights and is intended to limit the overall size of a bank's balance sheet relative to its capital. This reduces the ability of banks to manipulate their capital ratios through complex internal models.
- 59.** (A) I, II, and III only
Basel III improved upon its predecessor by increasing the capital adequacy ratio and adding capital conservation buffers. It also reduced risk-weight variability by limiting the use of internal models and introduced the leverage ratio as a non-risk-weighted backstop. Statement four is incorrect because Basel III mandates the holding of High-Quality Liquid Assets rather than eliminating their use.
- 60.** (B) Only II
The Available Unencumbered Assets tool tracks assets that are not currently pledged or restricted and thus have the potential to be used as collateral for raising additional secured funding. Statement one is incorrect because the tool focuses on assets that are currently unencumbered and available for use, rather than assets that are already locked in central bank reserves or encumbered.
- 61.** (C) ₹15,000 crores
For calculating the Liquidity Coverage Ratio, Level 2B assets are subject to a strict regulatory cap. They can represent no more than fifteen percent of the total adjusted stock of High-Quality Liquid Assets. Given that the bank intends to match its total HQLA to the one hundred thousand crores of net cash outflows, the maximum permitted value for Level 2B is fifteen thousand crores.
- 62.** (A) BLR-2, submitted Monthly
The Statement of Funding Concentration is designated as return BLR-2 under the Basel III liquidity reporting framework. This specific return is required to be submitted to the regulator on a monthly frequency. It must be filed within fifteen days of the end of the reporting month. This allows supervisors to monitor potential risks arising from the concentration of funding sources.
- 63.** (D) Assertion (A) is false, but Reason (R) is true.
The assertion is false because Level 2B assets are actually capped at fifteen percent of the total stock of High-Quality Liquid Assets, not forty percent. However, the reason is true; Level 2 assets as a whole, which include both Level 2A and Level 2B categories combined, are indeed capped at forty percent of the overall stock of liquid assets.

return from the forex swap operations yielded 4.32%. What is the net arbitrage gain for the bank compared to directly lending the surplus Rupee funds in the domestic money market?

- (A) 0.15%
- (B) 0.67%
- (C) 0.82%
- (D) 1.12%

Oct/Nov 2013

13. Which of the following provides the best definition of market risk as managed by an integrated treasury?

- (A) The risk that a standard retail customer will default on their primary mortgage or home loan obligations.
- (B) The operational risk of a payment system failure that prevents the processing of transactions on value dates.
- (C) The risk of adverse movements in currency, interest rates, and asset prices affecting treasury operations.
- (D) The risk that national regulatory agencies will implement a sudden ban on all derivatives trading activity.

May/June 2021

14. In the scenario describing the corporate dealer executing a trade that exceeds the client's limits, which division was responsible for monitoring the client's exposure limits and should have flagged the breach during the transaction phase?
- (A) The Dealing Room
 - (B) The Mid Office
 - (C) The Back Office
 - (D) The Accounts and Administration Department

Oct/Nov 2016

15. Arrange the following steps in the correct chronological sequence for identifying and encashing an interest arbitrage opportunity:
- I. Deploy dollar funds abroad to earn interest.
 - II. Compute prevailing Buy/Sell swap premium for USD/INR.
 - III. Execute a Buy/Sell swap to receive swap premium.
 - IV. Identify the availability of surplus Rupee funds.
- (A) II, IV, I, III
 - (B) IV, II, III, I
 - (C) IV, III, II, I

- (D) II, III, IV, I

May/June 2012

16. Based on the scenario provided below, answer the following questions:

Zenith Bank operates an integrated treasury that aggressively pursues profitability. On a given day, the treasury purchases USD 5 million from its exporter clients. Later in the afternoon, it sells USD 3 million to importer clients. Instead of squaring the remaining USD 2 million in the inter-bank market by the end of the day, the Chief Dealer decides to hold the position overnight, anticipating a favourable movement in the USD/INR exchange rate. This unhedged balance is maintained separately from the bank's long-term liquidity matching operations.

What is the term used to describe the un-squared USD 2 million balance held by the treasury at the end of the day?

- (A) Open position
- (B) Arbitrage position
- (C) Leveraged limit
- (D) Statutory balance

Oct/Nov 2022

17. Match the Treasury Division in List I with its corresponding primary function in List II.

List I: (Treasury Division)

- P. Front Office
- Q. Back Office
- R. Mid Office
- S. Investment Department

List II: (Primary Function)

- 1. Appraisal of credit risk for new non-SLR corporate debt issues.
 - 2. Verification and settlement of concluded deals.
 - 3. Execution of buying and selling in various markets.
 - 4. Monitoring exposure limits and providing MIS to management.
- (A) P-4, Q-1, R-2, S-3
 - (B) P-3, Q-2, R-4, S-1
 - (C) P-2, Q-3, R-1, S-4
 - (D) P-3, Q-4, R-1, S-2

May/June 2018

18. In which specific internal treasury book should this residual proprietary currency position be managed and recorded?
- (A) Trading Book

- 73.** (B) Quarterly, within 15 days
The Statement of Available Unencumbered Assets, coded as BLR-3, is a regulatory requirement for banks to report on their secondary sources of liquidity. Unlike the monthly LCR reports, this specific return must be submitted on a quarterly basis. The deadline for this submission is within fifteen days from the end of the respective quarter for which the data is being reported.
- 74.** (D) 0%
Coins and banknotes are the most liquid assets a bank can hold, as they can be used immediately to satisfy cash outflows. Under the Net Stable Funding Ratio framework, such highly liquid assets do not require any stable funding support. Consequently, they are assigned a zero percent Required Stable Funding factor, meaning they generate no additional stable funding requirement for the bank.
- 75.** (A) ₹40,000 crores
The Basel III framework limits the composition of the High-Quality Liquid Asset stock to ensure it consists primarily of the most liquid assets. Specifically, Level 2 assets, including both Level 2A and Level 2B categories combined, cannot exceed forty percent of the total HQLA. With a total HQLA target of one hundred thousand crores, the maximum allowed for Level 2 is forty thousand.
- 76.** (D) 90 days
The Facility to Avail Liquidity for Liquidity Coverage Ratio is designed as a temporary liquidity support measure for banks during periods of stress. According to the regulatory guidelines, funds obtained under this facility can be availed or rolled over for a total maximum duration of ninety days. This ensures that the facility provides relief while encouraging the bank to find permanent solutions.
- 77.** (C) 5%
Unconditionally revocable credit and liquidity facilities are off-balance sheet items that represent potential cash outflows for a bank. In the calculation of Required Stable Funding for the Net Stable Funding Ratio, these facilities are assigned a five percent factor. This percentage is applied to the currently undrawn portion of

the facility to determine the amount of stable funding the bank must maintain.

- 78.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The Net Stable Funding Ratio was introduced to reduce the banking sector's reliance on volatile, short-term wholesale funding. The reason correctly explains that by requiring banks to use more stable funding sources on an ongoing basis, the standard helps mitigate the risk of sudden liquidity shocks in the future. This promotes a more resilient funding structure for the bank's activities.
- 79.** (B) 6.00%
The interest rate for funds accessed through the Facility to Avail Liquidity for Liquidity Coverage Ratio is set at a penalty rate of two hundred basis points above the prevailing repo rate. If the Liquidity Adjustment Facility repo rate is four point zero zero percent, adding two hundred basis points results in an applicable interest rate of six percent for the bank.
- 80.** (A) 0%
Trade date payables arise from the purchase of financial instruments, commodities, or foreign currencies. In the context of the Net Stable Funding Ratio, these liabilities are not considered reliable sources of funding for the institution over a one-year horizon. Therefore, they are assigned an Available Stable Funding factor of zero percent, providing no contribution to the bank's stable funding total.

CHAPTER 19

Introduction to Treasury Management

Oct/Nov 2018

1. Which of the following is an incorrect statement regarding a bank's "open position" in foreign exchange?
 - (A) It represents the final overbought or oversold currency status of a banking institution at the end of the day.
 - (B) Banks maintain large open positions primarily to facilitate their day-to-day merchant business requirements.
 - (C) It involves substantial exchange risk because the market value of foreign currencies may change overnight.
 - (D) Individual dealers are instructed to maintain strictly limited open positions during regular intra-day trading.

May/June 2010

2. Consider the following statements regarding derivative products and risk management:
 - I. Credit Default Swaps (CDS) allow market participants to transfer and manage credit risk associated with corporate bonds.
 - II. Banks can act only as market-makers, but not as users, in the Credit Default Swaps market.
 - III. Interest Rate Futures (IRFs) are traded on recognized stock exchanges based on underlying government securities.
 - IV. Cross Currency Futures and Exchange Traded Options facilitate direct hedging of foreign currency exposures.
 - V. Equity derivatives are extensively utilized by bank treasuries for trading purposes as per regulatory guidelines.Which combination of the statements is correct?
 - (A) I, III, and IV only
 - (B) I, II, and III only
 - (C) II, IV, and V only
 - (D) III, IV, and V only

Oct/Nov 2014

3. Which of the following statements about the convertibility of the Rupee is incorrect?

- (A) The Rupee is freely convertible on the current account.
- (B) Foreign currency transactions on the current account are fully liberalized.
- (C) The Reserve Bank of India has permitted full convertibility of the currency on the capital account.
- (D) Government of India has largely removed sectoral caps for foreign investment, allowing flows by automatic route.

May/June 2025

4. Consider the following statements regarding the institutional structure and market characteristics:
 - I. The Clearing Corporation of India Limited (CCIL) maintains a Settlement Guarantee Fund by collecting margin money to avoid payment failures.
 - II. Demat accounts are maintained by depository participants to hold securities in electronic form.
 - III. Over-the-counter (OTC) markets refer to standardized derivative contracts traded on recognized exchanges.
 - IV. A bank's open position in foreign currency involves exchange risk.
 - V. Capital flows into an emerging market always lead to a strictly benign reduction in domestic interest rates without any volatility.

Which combination of the statements is correct?

- (A) II, III, and V only
- (B) I, II, and IV only
- (C) I, III, and IV only
- (D) I, IV, and V only

Oct/Nov 2021

5. All of the following are recognized routes for funds flow on the capital account, EXCEPT:
 - (A) External commercial borrowings
 - (B) Portfolio investment
 - (C) Payment on account of export-import trade
 - (D) Foreign Direct Investment

May/June 2011

6. Given below are two statements: one labeled as Assertion (A) and the other as Reason (R). Analyze the statements and choose the correct option.

Assertion (A): The primary market issues for corporate debt are generally handled by the Investment Department outside the Dealing Room.

Reason (R): Primary issues of corporate debt require thorough appraisal of credit risk, examination of issue terms, and detailed documentation, unlike secondary market trading.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2019

7. The treasury is required to maintain multiple books to manage its diverse roles. Which of the following is NOT a recognized book maintained by the treasury for this purpose?

- (A) Merchant Book
- (B) ALM Book
- (C) Trading Book
- (D) Statutory Compliance Book

May/June 2016

8. Given below are two statements: one labeled as Assertion (A) and the other as Reason (R). Analyze the statements and choose the correct option.

Assertion (A): Treasury profits have become attractive because treasury operations require extremely high capital allocation.

Reason (R): Treasury largely operates in inter-bank markets which are almost free of credit risk.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

9. All of the following departments or functions are considered part of the main treasury segregation, EXCEPT:

- (A) Front Office / Dealing Room
- (B) Mid-Office / Risk Management
- (C) Internal Audit and Corporate Human Resources
- (D) Back Office / Treasury Administration

May/June 2023

10. Based on the scenario provided below, answer the following questions:

A bank's Forex Treasury observes that the domestic money market offers an interest rate of 3.50% for deploying surplus Rupee funds for seven days. However, the Chief Dealer identifies an arbitrage opportunity. The spot exchange rate for USD/INR is INR 75.00, and the seven-day forward rate is INR 75.06. Simultaneously, dollar deposits placed abroad for seven days yield an annualized return of 0.15%. The bank decides to execute a Buy/Sell swap to capitalize on this situation instead of lending directly in the domestic money market.

What is the annualized yield generated specifically from the USD/INR swap premium for the seven-day period?

- (A) 4.17%
- (B) 3.50%
- (C) 4.32%
- (D) 0.82%

Oct/Nov 2005

11. What is the most appropriate rationale for setting up the treasury as a specialized branch rather than a department at the head office?

- (A) It entirely removes the treasury from the purview of central bank regulatory inspections.
- (B) It merges the treasury directly with retail banking operations to maximize customer footfall.
- (C) It eliminates the need to segregate the front office and back office functions, saving operational costs.
- (D) It allows the branch to act as an Authorised Dealer and participate directly in clearing and settlement systems.

May/June 2014

12. In the described arbitrage scenario, the domestic money market offered 3.50% while the total

NODIA

transactions - Merchant Book

May/June 2005

26. How is "Arbitrage" defined in the context of treasury operations?
- (A) The profit earned by simultaneously trading in different markets to exploit price imperfections.
 - (B) The speculative acquisition of various assets to benefit from long-term trends in macroeconomic growth.
 - (C) The process of generating high transaction volumes using relatively small amounts of allocated capital.
 - (D) The regulatory obligation to maintain high cash reserves to prevent defaults by institutional counterparties.

Oct/Nov 2020

27. Consider the following statements:
- I. Treasury essentially deals with short-term funds-flow with maturities of less than one year.
 - II. The risk management function within a bank covers underlying assets and liabilities across short, medium, and long-term maturities.

Which of the above statement(s) is/are correct?

- (A) Only Statement I is correct
- (B) Only Statement II is correct
- (C) Both statements are correct
- (D) Both statements are incorrect

May/June 2019

28. How is "Speculation" defined in the context of financial markets?
- (A) The hedging of corporate exposures using standardized and regulated forward rate agreements.
 - (B) The strategic matching of long-term liabilities with short-term assets to optimize liquidity.
 - (C) The execution of trades across multiple markets to capture risk-free interest rate differentials.
 - (D) Buying or selling assets to profit from price movements over a specific period.

Oct/Nov 2008

29. Consider the following statements:
- I. The securities dealer in the dealing room exclusively buys and sells corporate debt

issues directly from the primary market.

- II. Treasury operations are strictly restricted from participating in the primary auction of government securities conducted by the central bank.

Which of the above statement(s) is/are correct?

- (A) Only Statement I is correct
- (B) Only Statement II is correct
- (C) Both statements are correct
- (D) Both statements are incorrect

May/June 2013

30. What is the minimum marketable investment amount for primary issues considered by the Investment Department?
- (A) Rs. 1 crore
 - (B) Rs. 2 crores
 - (C) Rs. 5 crores
 - (D) Rs. 10 crores

Oct/Nov 2025

31. Consider the following statements regarding the conventional sources of Treasury profits:
- I. The difference between the buy and sell rates in foreign exchange business is known as the spread.
 - II. Funds lent in the money market consistently generate high profits because they originate from cost-free deposits.
 - III. Historically, income from risk-free investments in government securities was not considered a significant source of profit.
- Which the statements given above is/are correct?
- (A) I and III only
 - (B) I and II only
 - (C) II and III only
 - (D) I, II, and III

May/June 2017

32. Which Act replaced the earlier Foreign Exchange Regulation Act (FERA) to facilitate progressive relaxation of exchange controls?
- (A) Foreign Exchange Management Act (FEMA) of 1999
 - (B) Financial Assets Securitization Act (FASA) of 2002
 - (C) Capital Account Convertibility Act (CACA) of 1999
 - (D) Global Financial Integration Act (GFIA) of 2004

- (B) Merchant Book
- (C) ALM Book
- (D) Transfer Pricing Book

Oct/Nov 2007

- 19.** Match the financial instrument or term in List I with its correct description in List II.

List I: (Financial Instrument or Term)

- P. Forward Rate Agreement (FRA)
- Q. Credit Default Swaps (CDS)
- R. Securitized Assets
- S. Triparty Repo

List II: (Description)

1. Used to optimize return on funds by borrowing or lending short-term.
2. Pass-through certificates issued by special purpose vehicles.
3. Used to fix the interest rate for a future issuance of commercial paper.
4. Provides protection against specific credit risk on corporate bonds.

- (A) P-4, Q-3, R-1, S-2
- (B) P-2, Q-1, R-4, S-3
- (C) P-3, Q-4, R-2, S-1
- (D) P-3, Q-2, R-4, S-1

May/June 2024

- 20.** In the scenario provided, the surge in portfolio investments from FIIs into the domestic market demonstrates a characteristic of which phenomenon?

- (A) Partial convertibility on the current account
- (B) The process of Globalisation
- (C) Complete insulation of domestic markets
- (D) Elimination of foreign exchange reserves

Oct/Nov 2015

- 21.** Match the keyword in List I with its correct definition in List II.

List I: (Keyword)

- P. Leveraging
- Q. Speculation
- R. Arbitrage
- S. Emerging Market Countries

List II: (Definition)

1. Benefit accruing to traders playing in different markets simultaneously.
2. Fast developing economies largely market driven.
3. Buying or selling an asset only to make profit from price movement.
4. Building up large volumes of business on

relatively small capital.

- (A) P-3, Q-4, R-2, S-1
- (B) P-1, Q-2, R-3, S-4
- (C) P-4, Q-3, R-1, S-2
- (D) P-2, Q-1, R-4, S-3

May/June 2022

- 22.** Under the new approach mandated by the CTO, what critical element is added to the historical interest cost when calculating the transfer price?

- (A) The operational cost of the retail branch network.
- (B) The margin money collected by the clearing corporation.
- (C) The default risk of sovereign government securities.
- (D) The cost of hedging or the cost of risk.

Oct/Nov 2011

- 23.** Which of the following correctly pairs a financial market segment with its associated activity?

- (A) Wholesale Debt Market - Trading exclusively in pass-through certificates
- (B) Primary Corporate Debt Market - Dealing in Government T-bills
- (C) Equity Market - Direct trading in Credit Default Swaps
- (D) Over-The-Counter (OTC) Market - Trading customized derivative products like Forward Rate Agreements

May/June 2007

- 24.** In the context of the scenario where the CTO mandates advanced models, which specific pricing model is commonly evolved by banks to compute capital requirements and graduate to superior risk management approaches?

- (A) Capital Asset Pricing Model (CAPM)
- (B) Risk Adjusted Return On Capital (RAROC)
- (C) Weighted Average Cost of Capital (WACC)
- (D) Net Present Value (NPV) margin

Oct/Nov 2009

- 25.** Which of the following pairs of treasury activity and corresponding book is incorrectly matched?

- (A) Managing internal risk and traditional liquidity - ALM Book
- (B) Managing proprietary trading and profit generation - Trading Book
- (C) Managing risks inherent in proprietary positions - Merchant Book
- (D) Managing client-related currency

Oct/Nov 2018

39. Consider the following statements regarding interest arbitrage:

- I. It involves taking advantage of interest differentials across currency and security markets.
- II. Banks may borrow in USD and lend in Rupee inter-bank markets depending on interest rates.
- III. Banks are strictly prohibited from borrowing large amounts in the money market to lend to other highly rated institutions.
- IV. The development of futures markets provides treasuries with opportunities to arbitrage between OTC and futures markets.

Which combination of the statements is correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, and IV only

May/June 2006

40. Which of the following correctly identifies a driving force for the integration of treasury operations?

- (A) The regulatory mandate to completely separate Rupee cash flows from foreign currency cash flows.
- (B) The corporate demand for high-end services, requiring an integrated service from the bank.
- (C) The necessity to compartmentalize risk management techniques strictly by individual market segments.
- (D) The prohibition of interest arbitrage across differing currency markets to maintain economic stability.

Oct/Nov 2017

41. Consider the following statements regarding trading and investment activities:

- I. Speculative trading generates profits from favourable price movements during the interval between buying and selling.
- II. Banks in India are permitted by the regulator to engage in short selling of equities.
- III. Banks holding an Authorized Dealer Category 1 licence are permitted to trade in currencies within pre-set limits.
- IV. Treasuries aggressively trade in government securities to manage liquidity and generate profits beyond SLR requirements.

V. Investment in securitized credit receivables commonly involves pass-through certificates.

Which combination of the statements is correct?

- (A) I, II, III, and IV only
- (B) II, III, IV, and V only
- (C) I, III, IV, and V only
- (D) I, II, IV, and V only

May/June 2008

42. Which of the following is an incorrect statement regarding the preferred organisational structure of a bank treasury?

- (A) The treasury operates with zero autonomy and shares a unified accounting system with retail branches.
- (B) Specialized treasury branches are often preferred because they can maintain independent and separate books.
- (C) Specialized treasury branches provide the benefit of acting as an Authorised Dealer for all forex business.
- (D) The departmental structure facilitates easier coordination with head office units within a line management setup.

Oct/Nov 2006

43. Consider the following statements regarding the roles of Treasury:

- I. Liquidity Management involves managing funds across currencies and complying with reserve requirements.
- II. Proprietary Positions refer to treasury trading in financial instruments purely to hedge customer risks.
- III. Risk Management involves bridging asset-liability mismatches.
- IV. The ALM Book is maintained primarily for client-related currency and derivative transactions.
- V. The Trading Book is exclusively used to manage the risks inherent in the bank's proprietary positions.

Which combination of the statements is correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, IV, and V only
- (D) I, III, and V only

Oct/Nov 2010

33. Consider the following statements regarding funds flow on the capital account:
- I. Foreign institutional investors investing long-term funds in domestic companies represents portfolio investment.
 - II. External commercial borrowings and overseas direct investments are major routes for capital flows.
 - III. Remittances by individuals for miscellaneous purposes are strictly classified as capital account transactions.
- Which the statements given above is/are correct?
- (A) I and II only
 - (B) II only
 - (C) II and III only
 - (D) I, II, and III

May/June 2020

34. The concept of “Integrated Treasury” in a banking setup primarily refers to the integration of which specific operations?
- (A) Money market, securities market, and foreign exchange operations.
 - (B) Retail banking, corporate lending, and wealth management operations.
 - (C) Branch clearing operations, cash remittances, and internet banking gateways.
 - (D) Human resources administration, systemic IT maintenance, and mid-office compliance.

Oct/Nov 2012

35. Consider the following statements regarding the functions of an Integrated Treasury:
- I. Meeting CRR and SLR requirements is no longer a function of an integrated treasury.
 - II. Optimising profit by encashing market opportunities in money and securities markets is a core function.
 - III. Integrated Treasury involves assisting bank management in Asset-Liability Management (ALM).
 - IV. Providing efficient merchant services, including forex and advisory services, is an integral part of treasury functions.
- Which combination of the statements is correct?
- (A) I, II, and III only
 - (B) I, III, and IV only
 - (C) II, III, and IV only
 - (D) I, II, III, and IV

May/June 2009

36. Why is the Mid-Office typically structured to report to the Head of the Risk Management Department rather than the Head of Treasury?
- (A) To exclusively manage primary corporate debt trades that require specialized and independent credit appraisals.
 - (B) To ensure independent compliance and objectively report total market risk to top management.
 - (C) To gain direct and uninhibited access to settlement guarantee funds maintained by external clearing corporations.
 - (D) To facilitate unhedged proprietary trading positions without being restricted by dealer-level stop-loss limits.

Oct/Nov 2023

37. Consider the following statements regarding the functions of the Back-Office:
- I. It independently confirms deals with counterparties.
 - II. It verifies the authenticity of confirmation documents.
 - III. It takes care of all related book-keeping and submission of periodical returns to the central bank.
 - IV. It monitors exposure limits and stop-loss limits of the treasury.
- Which combination of the statements is correct?
- (A) I, II, and IV only
 - (B) II, III, and IV only
 - (C) I, II, and III only
 - (D) I, III, and IV only

May/June 2015

38. Which of the following correctly describes the handling of corporate debt primary market issues within a bank's treasury?
- (A) The Chief Dealer executes them directly in the Front Office without performing an independent credit appraisal.
 - (B) The Back Office manages them to ensure immediate cash settlement before any formal risk evaluation occurs.
 - (C) Equity dealers trade them exclusively on the wholesale debt segments of the national securities exchanges.
 - (D) The Investment Department handles them outside the Dealing Room to ensure proper credit risk appraisal.

64. (A) 100%

Tier 1 regulatory capital represents the highest quality and most permanent form of a bank's capital. In the calculation of the Net Stable Funding Ratio, such instruments are considered the most reliable sources of funding. Therefore, they are assigned an Available Stable Funding factor of one hundred percent, reflecting their availability to the bank for a period exceeding one year.

65. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The leverage ratio was introduced as a transparent, non-risk-based measure because the global financial crisis showed that banks could maintain high risk-based capital ratios while still being over-leveraged. By exploiting the variability in risk weights, banks appeared safer than they actually were. The leverage ratio provides a necessary backstop that does not depend on internal risk models or weights.

66. (B) ₹1,800 crores

Under the Net Stable Funding Ratio framework, unencumbered Level 2A assets are assigned a fifteen percent Required Stable Funding factor. To find the amount of stable funding these assets generate, the bank multiplies the asset value by this factor. Therefore, for twelve thousand crores of Level 2A assets, the required stable funding amount is fifteen percent of twelve thousand, which equals eighteen hundred crores.

67. (C) Furnish a declaration stating that the bank has exhausted all its other HQLAs.

The Facility to Avail Liquidity for Liquidity Coverage Ratio is intended to be used only as a last resort during extreme liquidity stress. Consequently, banks are not permitted to access this facility until they have utilized all other available High-Quality Liquid Assets. A mandatory procedural requirement is for the bank's management to furnish a formal declaration confirming this exhaustion before seeking funds.

68. (C) Assertion (A) is true, but Reason (R) is false. The assertion is true because Cash Reserve Ratio balances, including excess reserves, are assigned a zero percent Required Stable Funding factor,

meaning they require no stable funding support. However, the reason is false; CRR balances represent central bank claims, which are the most liquid and safest assets, rather than assets with a high liquidity risk profile that need stable funding.

69. (D) Within 15 days of the reporting month

The Statement on Liquidity Coverage Ratio, known as BLR-1, is a monthly regulatory return. Banks must submit this return to the central bank within fifteen days of the end of the month being reported. This timely submission is essential for supervisors to monitor the short-term liquidity health of the banking system and identify any banks that may be facing potential stress.

70. (C) ₹28,500 crores

Stable non-maturity retail deposits are considered a highly reliable source of funding and are assigned a ninety-five percent Available Stable Funding factor under the NSFR framework. For a deposit amount of thirty thousand crores, the bank calculates the ASF value by taking ninety-five percent of that total. This result is twenty-eight thousand five hundred crores, which is then added to total ASF.

(D) Assertion (A) is false, but Reason (R) is true. The assertion is false because the Liquidity Coverage Ratio is specifically designed to promote short-term resilience, rather than medium to longer-term resilience. The reason provided is true; the LCR ensures that banks maintain sufficient High-Quality Liquid Assets to survive an acute stress scenario over a thirty-day horizon. Longer-term resilience is addressed by the Net Stable Funding Ratio instead of LCR.

72. (D) ₹8,500 crores

Level 2A assets are subject to a fifteen percent haircut when calculating the total stock of High-Quality Liquid Assets. This means only eighty-five percent of the asset's current value is considered for regulatory purposes. For ten thousand crores of Level 2A assets, applying a fifteen percent haircut results in a value of eight thousand five hundred crores to be included in HQLA.

May/June 2021

44. Which of the following is an incorrect statement regarding the functions of the back-office in a treasury?
- (A) It confirms deals independently with counterparties over phone or digitally.
 - (B) It maintains and reconciles Nostro accounts and Demat accounts.
 - (C) It verifies the authenticity of confirmation documents and manages the settlement process.
 - (D) It monitors exposure limits, stop loss limits, and implements the Transfer Pricing Mechanism.

Oct/Nov 2024

45. Given below are two statements: one labeled as Assertion (A) and the other as Reason (R). Analyze the statements and choose the correct option.
- Assertion (A): In the context of integrated treasury operations, organizing the treasury as a specialized branch is generally preferred over a department structure.
- Reason (R): A treasury branch can maintain its books of accounts independently and can act directly as an Authorised Dealer for foreign exchange clearing and settlement systems.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2023

46. Which of the following is NOT one of the primary functions of an Integrated Treasury?
- (A) Meeting reserve requirements including CRR and SLR.
 - (B) Originating retail mortgage loans for individual banking customers.
 - (C) Assisting bank management in Asset-Liability Management.
 - (D) Implementing Funds Transfer Pricing to allocate costs rationally.

Oct/Nov 2014

47. Given below are two statements: one labeled as Assertion (A) and the other as Reason (R).

Analyze the statements and choose the correct option.

Assertion (A): The Mid-Office in a bank's treasury should ideally report to the Head of the Risk Management Department rather than the Head of Treasury.

Reason (R): This reporting structure ensures objective monitoring of exposure limits and compliance with prudential parameters without interference from the trading desks.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2025

48. Which of the following is NOT cited as a reason making treasury profits highly attractive to banks?
- (A) Treasury requires high capital allocation due to the immense credit risk found in inter-bank markets.
 - (B) Treasury activity is highly leveraged, which facilitates significantly high returns on the allocated capital.
 - (C) Treasury operational costs are generally lower than those associated with traditional retail branch banking.
 - (D) Treasury generates substantial profit by processing high volumes of business despite having narrow spreads.

Oct/Nov 2021

49. Given below are two statements: one labeled as Assertion (A) and the other as Reason (R). Analyze the statements and choose the correct option.
- Assertion (A): The risk management function in a bank's treasury covers underlying assets and liabilities across short, medium, and long-term maturities.
- Reason (R): Treasury essentially deals only with long-term funds-flow exceeding one year maturity.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true,

banks to conduct interest arbitrage across global markets.

May/June 2022

62. Which of the following correctly pairs a source of treasury profit with its primary characteristic?
- (A) Interest Arbitrage - Long-term holding of non-SLR bonds
 - (B) Merchant Business - Earning from the buy-sell spread of foreign currency
 - (C) Equity Trading - Hedging export receivables
 - (D) Transfer Pricing - Earning dividends from subsidiary companies

Oct/Nov 2011

63. By acting as the central funding centre and adding a small margin during the transfer pricing process, the treasury in the scenario is primarily functioning as a:
- (A) Profit centre
 - (B) Compliance centre
 - (C) Service centre
 - (D) Depository participant

May/June 2007

64. Which of the following pairs of treasury risk or position is incorrectly matched?
- (A) Open position - Credit risk due to counterparties defaulting on primary debt
 - (B) Open position - Exchange risk due to overbought or oversold status
 - (C) Proprietary trading in a rising market - Profit realization when yields fall
 - (D) Short selling - Speculative activity to profit from falling asset prices

Oct/Nov 2009

65. What is the definition of "Globalisation" in the context of financial markets?
- (A) The total removal of national oversight to facilitate unrestricted cross-border financial and banking operations.
 - (B) The integration of domestic and global markets through free capital flows and minimal regulation.
 - (C) The mandatory conversion of all internal deposits into foreign assets that are traded on global exchanges.
 - (D) The consolidation of every international financial trade through a centralized and sovereign clearing entity.

May/June 2005

66. Consider the following statements:
- I. It is mandatory that the Front Office and Back Office are totally segregated and report to two different managers.
 - II. The Mid-Office is heavily involved in the day-to-day execution of trades and reports directly to the Chief Dealer.
- Which of the above statement(s) is/are correct?
- (A) Only Statement I is correct
 - (B) Only Statement II is correct
 - (C) Both statements are correct
 - (D) Both statements are incorrect

Oct/Nov 2020

67. What is the definition of "Tradable assets"?
- (A) Fixed infrastructure and physical equipment used by the bank to support specialized dealing room operations.
 - (B) Highly illiquid and customized loan portfolios managed exclusively within the bank's asset-liability framework.
 - (C) Financial instruments like bonds and currencies that are primarily traded in electronic form.
 - (D) Sovereign wealth funds that are directly overseen and managed solely by the national central banking authority.

May/June 2019

68. Consider the following statements:
- I. Bank treasuries generally do not maintain an open position of foreign currency solely for the purpose of facilitating merchant business.
 - II. A bank's open position at the end of the day involves exchange risk, as the value of foreign currency may change overnight.
- Which of the above statement(s) is/are correct?
- (A) Only Statement I is correct
 - (B) Only Statement II is correct
 - (C) Both statements are correct
 - (D) Both statements are incorrect

Oct/Nov 2008

69. What is the general minimum transaction size handled by the specialist staff in a bank's Treasury?
- (A) Rs. 5 million
 - (B) Rs. 10 million
 - (C) Rs. 50 million
 - (D) Rs. 100 million

primary market debt issues.

- (D) Regulatory mandates require strict segregation between deal execution and deal settlement to avoid financial loss and defaults.

May/June 2012

56. Arrange the following stages of a treasury transaction in the correct sequential flow:
- I. Execution of the deal in the secondary market.
 - II. Preparation of deal slips.
 - III. Confirmation of the deal independently with counterparties.
 - IV. Settlement and receipt/payment on value date.
- (A) II, I, IV, III
(B) I, II, III, IV
(C) I, III, II, IV
(D) III, I, II, IV

Oct/Nov 2005

57. By intentionally holding the un-squared USD balance overnight to profit from favourable exchange rate movements, the treasury is primarily engaging in which of the following activities?
- (A) Credit Default Swapping
(B) Transfer Pricing
(C) Speculation / Trading
(D) Liquidity Management

May/June 2018

58. Match the specific Treasury Book in List I with its intended purpose in List II.
- List I: (Treasury Book)
- P. ALM Book
Q. Merchant Book
R. Trading Book
S. Nostro Accounts
- List II: (Intended Purpose)
1. Managing risks in client-related currency and derivative transactions.
 2. Managing the traditional role of liquidity and internal risk management.
 3. Managing risks inherent in proprietary positions to contribute to profits.
 4. Managing foreign currency accounts maintained with correspondent banks.
- (A) P-2, Q-1, R-3, S-4
(B) P-1, Q-3, R-2, S-4
(C) P-3, Q-2, R-4, S-1

(D) P-2, Q-4, R-1, S-3

Oct/Nov 2007

59. The outward remittance by the Indian corporate to acquire the European company represents a capital flow primarily through which route?
- (A) Foreign Direct Investment in domestic infrastructure.
(B) External Commercial Borrowings for local projects.
(C) Portfolio Investment in the national stock market.
(D) Overseas Direct Investment and global Mergers & Acquisitions.

May/June 2024

60. Match the institutional entity in List I with its corresponding role in the financial market in List II.
- List I: (Institutional Entity)
- P. CCIL
Q. NSDL
R. RBI
S. SEBI
- List II: (Role in the Financial Market)
1. Maintains Settlement Guarantee Fund to avoid payment failures.
 2. Maintains Demat accounts to hold securities in electronic form.
 3. Restricts banks' exposure to capital markets by imposing limits.
 4. Regulates mutual funds and investment institutions along with other agencies.
- (A) P-2, Q-1, R-4, S-3
(B) P-3, Q-4, R-1, S-2
(C) P-4, Q-3, R-2, S-1
(D) P-1, Q-2, R-3, S-4

Oct/Nov 2015

61. In the same scenario, why is the central bank likely monitoring the capital inflows despite them supplementing domestic capital?
- (A) Capital inflows lead to a reduction in the Statutory Liquidity Ratio requirements for commercial banks.
(B) Portfolio investments from foreign entities are strictly prohibited under existing exchange laws.
(C) Sudden portfolio shifts increase volatility in prices and rates, making the economy vulnerable.
(D) Capital inflows remove the opportunity for

9. (C) Internal Audit and Corporate Human Resources

A bank treasury is structurally divided into three distinct functional areas to ensure internal control and efficiency. The front office handles deal execution, the mid-office manages risk and compliance, and the back office oversees administration and settlement. General corporate functions like internal audit and human resources are independent departments and are not considered part of the core treasury segregation.

10. (A) 4.17%

The swap premium is calculated as the difference between the forward rate and the spot rate. Dividing the premium of six paise by the spot rate of seventy-five rupees results in the periodic return. Annualizing this return over a three hundred and sixty-five day basis for the seven-day period yields approximately four point one seven percent per annum.

11. (D) It allows the branch to act as an Authorised Dealer and participate directly in clearing and settlement systems.

Operating a treasury as a specialized branch provides significant operational advantages. It enables the unit to maintain independent books of accounts and act directly as an Authorised Dealer for foreign exchange transactions. This structure facilitates seamless participation in clearing and settlement systems, which is more efficient than functioning as a head office department with centralized accounting and reporting.

12. (C) 0.82%

The bank generates a total return of four point three two percent from the combined swap premium and the offshore dollar deposit interest. By comparing this total yield to the domestic money market rate of three point five zero percent, the net benefit is determined. This resulting difference of zero point eight two percent represents the additional arbitrage profit achieved.

13. (C) The risk of adverse movements in currency, interest rates, and asset prices affecting treasury operations.

Market risk in the context of an integrated treasury refers to the potential for financial loss

resulting from fluctuations in market variables. These variables include foreign exchange rates, interest rates, and equity prices. Managing this risk is crucial as these movements directly impact the valuation of the treasury's trading positions and the bank's overall portfolio of financial assets.

14. (B) The Mid Office

The mid-office serves as an independent risk management unit within the treasury structure. Its primary responsibilities include monitoring exposure limits, ensuring compliance with internal and regulatory guidelines, and reporting breaches to senior management. Therefore, it is the specific division tasked with flagging instances where a corporate dealer executes a trade that exceeds a client's established credit or transaction limits.

15. (B) IV, II, III, I

The process begins by identifying available surplus funds in the domestic currency. Next, the treasury computes the prevailing swap premiums to evaluate the potential profitability of the operation. Once the arbitrage opportunity is confirmed, a swap is executed to convert funds and capture the premium. Finally, the resulting foreign currency funds are deployed abroad to earn additional interest.

16. (A) Open position

An open position occurs when the total purchases of a foreign currency do not equal the total sales at the end of a business day. This results in either an overbought or oversold status. Holding such a balance overnight exposes the bank to exchange risk, as the market value of the currency may fluctuate before the position is squared.

17. (B) P-3, Q-2, R-4, S-1

The front office is responsible for executing trades in various financial markets. The back office handles the verification and settlement of these concluded deals. The mid-office focuses on monitoring exposure limits and providing management information systems. Finally, the investment department specializes in the credit appraisal and management of primary market non-statutory liquidity ratio corporate debt issues.

May/June 2013

70. Consider the following statements regarding the impact of globalisation on domestic financial markets:

- I. Interest rates are influenced by global interest rate trends due to cross border capital flows.
- II. New institutional structures like clearing corporations and depositories have emerged to support financial markets.
- III. Rupee derivatives such as swaps, forwards, and options have been completely banned to prevent systemic risks.

Which the statements given above is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2025

71. What is the maximum limit up to which the Reserve Bank of India permits banks to borrow through their overseas correspondents in foreign currency?

- (A) 50% of unimpaired tier-1 capital, or USD 5 million, whichever is lower.
- (B) 100% of unimpaired tier-1 capital, or USD 10 million, whichever is higher.
- (C) 150% of unimpaired tier-1 capital, or USD 20 million, whichever is lower.
- (D) 200% of unimpaired tier-2 capital, or USD 50 million, whichever is higher.

May/June 2017

72. Consider the following statements regarding Treasury products:

- I. Large corporates utilize derivative products solely for speculative purposes and never to hedge risks.
- II. A Forward Rate Agreement (FRA) can be used by a company to fix the interest rate for future commercial paper issuance.
- III. An interest rate swap can convert a floating rate loan into a fixed rate loan to eliminate interest rate risk.

Which the statements given above is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2010

73. Which of the following best represents the transformation of the treasury function due to economic reforms in the 1990s?

- (A) From an independent specialized branch to a subservient head office department managing statutory liquidity strictly.
- (B) From handling global funds solely to focusing exclusively on domestic retail credit syndication.
- (C) From a strict compliance and service centre to an active profit centre with proprietary trading and investment activity.
- (D) From managing long-term structural credit risks to exclusively managing short-term overhead expenses.

May/June 2020

74. Consider the following statements regarding the evolving role of treasury as a profit centre:

- I. Treasury operations require extremely high capital allocation compared to retail branch banking.
- II. Operational costs in treasury are relatively low because the unit transaction sizes are generally very large.
- III. Treasury generates profit primarily from high volumes of business operating on narrow spreads.

Which the statements given above is/are correct?

- (A) II and III only
- (B) I and II only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2012

75. How does the Asset-Liability Management (ALM) Book differ from the Trading Book within a bank's treasury?

- (A) The ALM Book is used for speculative foreign exchange profits, while the Trading Book manages long-term structural credit risks.
- (B) The ALM Book records only client-related merchant transactions, while the Trading Book strictly holds statutory reserve balances.
- (C) The ALM Book is exclusively maintained by the Back Office, while the Trading Book is maintained solely by the Mid Office.
- (D) The ALM Book manages internal risk and liquidity mismatches, while the Trading

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in aligning prices across markets and is a core function of an integrated treasury seeking to optimize returns through sophisticated cross-market strategies.

27. (C) Both statements are correct

Treasury operations primarily focus on managing short-term funds and cash flows, typically with maturities of less than one year. However, the risk management function within the bank has a much broader scope. It is responsible for monitoring and mitigating risks across the entire balance sheet, covering underlying assets and liabilities spanning short, medium, and long-term maturity profiles.

28. (D) Buying or selling assets to profit from price movements over a specific period.

Speculation involves taking a deliberate market position in a financial asset, such as a currency or security, with the expectation of profiting from future price changes. Unlike hedging, which aims to reduce risk, speculation involves accepting risk to achieve gains. This activity is a significant component of the trading book in a bank's treasury, contributing to overall profitability.

29. (D) Both statements are incorrect

Corporate debt primary market issues are typically handled by a specialized investment department to allow for thorough credit appraisal, rather than by secondary market dealers. Furthermore, bank treasuries are active participants in primary auctions of government securities conducted by the central bank. These auctions are a key method for banks to manage their statutory liquidity ratio requirements and portfolios.

30. (C) Rs. 5 crores

The investment department within a bank treasury focuses on primary market issuances of corporate debt and other non-statutory liquidity ratio securities. Due to the high administrative and appraisal costs involved, these departments typically consider only large-scale investments. A minimum marketable amount of five crore rupees is generally required for these transactions to be considered viable and efficient.

31. (A) I and III only

Treasury profit is traditionally derived from the spread between buying and selling rates in

foreign exchange. Historically, income from low-risk government securities was a major source of earnings. However, funds lent in the money market are not purely cost-free, as they originate from various deposit sources with associated costs. Modern treasuries now focus more on trading and arbitrage for profit.

32. (A) Foreign Exchange Management Act (FEMA) of 1999

The Foreign Exchange Management Act of 1999 was introduced to replace the more restrictive Foreign Exchange Regulation Act. This legislative change was aimed at facilitating external trade and payments while promoting the orderly development and maintenance of the foreign exchange market. It marked a significant shift from a regime of strict control to one focused on management and progressive liberalization.

33. (A) I and II only

Capital account transactions include long-term investments like foreign portfolio investment and direct investment, as well as external commercial borrowings. These transactions change the asset and liability status of residents and non-residents. While individual remittances for specific purposes are permitted, small miscellaneous remittances for personal consumption are typically classified under the current account rather than the capital account of the balance.

34. (A) Money market, securities market, and foreign exchange operations.

An integrated treasury refers to the unification of a bank's money market, securities, and foreign exchange desks into a single functional unit. This structure allows the bank to manage its total liquidity and risk holistically. By integrating these operations, the bank can optimize funds across different markets, execute arbitrage opportunities more effectively, and provide comprehensive financial services to corporate clients.

35. (C) II, III, and IV only

Integrated treasury departments remain responsible for meeting statutory reserve requirements like cash reserve and statutory liquidity ratios. Beyond compliance, they optimize profits through market trading and support the bank's asset-liability committee in managing structural risks. They also provide

ANSWERS

1. (B) Banks maintain large open positions primarily to facilitate their day-to-day merchant business requirements.
An open position represents the net overbought or oversold status of a currency at the end of a trading day. While individual dealers operate within strict intra-day limits, the overnight position carries significant exchange risk. Banks typically aim to square positions and do not maintain large open positions just to facilitate routine merchant requirements.
2. (A) I, III, and IV only
Credit Default Swaps enable participants to manage credit risk on corporate bonds. Banks act as both market-makers and users in this market. Interest Rate Futures are exchange-traded instruments based on government securities for hedging interest rate risks. Cross-currency futures and options also facilitate direct hedging. Equity derivatives are generally not used extensively by bank treasuries for trading.
3. (C) The Reserve Bank of India has permitted full convertibility of the currency on the capital account.
The Indian Rupee is fully convertible on the current account, meaning transactions related to trade and services are liberalized. However, the capital account is only partially convertible. While the government has increased sectoral caps for foreign investments via the automatic route, the Reserve Bank of India has not yet permitted full convertibility for all capital account transactions.
4. (B) I, II, and IV only
The Clearing Corporation of India Limited ensures settlement by maintaining a Guarantee Fund through margin collections. Depository participants maintain Demat accounts for electronic security holding. Open positions in foreign exchange inherently involve exchange risk due to price volatility. However, over-the-counter markets involve customized rather than standardized contracts, and capital inflows often cause significant volatility in emerging markets.
5. (C) Payment on account of export-import trade
Capital account transactions involve changes in the assets and liabilities of residents outside the country or non-residents within the country. This includes external commercial borrowings, foreign direct investment, and portfolio investments. Conversely, payments for export and import trade are categorized as current account transactions because they relate to the actual exchange of goods and services.
6. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Primary market issues for corporate debt require meticulous credit risk appraisal and detailed documentation. This process differs significantly from the rapid execution found in secondary market trading within a dealing room. Consequently, banks often handle these primary issuances through a specialized investment department located outside the main treasury dealing area to ensure thorough evaluation.
7. (D) Statutory Compliance Book
Bank treasuries maintain specific books to track different operational roles. The Merchant Book records customer-related transactions, while the Trading Book tracks proprietary positions for profit. The Asset-Liability Management Book focuses on internal liquidity and risk management. While treasuries must comply with regulations, a specific statutory compliance book is not a recognized functional book for managing treasury operations.
8. (D) Assertion (A) is false, but Reason (R) is true.
Treasury operations are attractive because they are highly leveraged, requiring relatively low capital allocation compared to traditional retail banking. The high returns on capital are driven by large volumes and narrow spreads. Furthermore, the treasury operates primarily in inter-bank markets, which are characterized by very low credit risk, although market risks like interest rate fluctuations remain.

Book manages risks inherent in proprietary positions.

May/June 2009

76. Consider the following statements regarding the organisation of a bank treasury:

- I. The treasury is headed by a Chief Treasury Officer or General Manager reporting to the CFO or CEO.
- II. The treasury is typically segregated into three main divisions: Dealing Room, Mid-Office, and Back-Office.
- III. A specialized treasury branch enjoys the advantage of acting directly as an Authorised Dealer for forex business.
- IV. The Mid-Office exclusively handles the verification and settlement of deals concluded by the front office.

Which combination of the statements is correct?

- (A) II, III, and IV only
- (B) I, III, and IV only
- (C) I, II, III, and IV
- (D) I, II, and III only

Oct/Nov 2023

77. Which of the following is a correct statement regarding the maturity profile of treasury deals and risk management functions?

- (A) Treasury focuses on assets exceeding five years, whereas risk management handles daily operational liquidity needs.
- (B) Both treasury and risk management departments are strictly limited to overnight and intra-day transaction maturities.
- (C) Treasury handles short-term flows under one year, while risk management covers all asset maturities.
- (D) Treasury operations are confined to long-term durations, while risk management only tracks short-term trading risk.

May/June 2015

78. Consider the following statements regarding the Mid-Office:

- I. It provides Management Information Systems (MIS) to the top management.
- II. It is functionally responsible for the day-to-day execution of equity trades.
- III. It appraises the ALCO regarding adherence to prudential and risk parameters.
- IV. It may oversee the Transfer Pricing Mechanism and ALM support functions.

Which combination of the statements is correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

May/June 2006

79. Which of the following is a correct statement regarding the impact of globalisation on domestic interest rates?

- (A) Domestic interest rates are influenced by global interest rate trends due to cross border capital flows.
- (B) Domestic interest rates are entirely insulated from global markets due to strict regulatory intervention by the central bank.
- (C) Globalisation forces domestic interest rates to permanently peg to the prevailing rates in developed global inter-bank markets.
- (D) The impact of globalisation results in the immediate elimination of all interest rate differentials between domestic and foreign markets.

Oct/Nov 2017

80. Consider the following statements regarding the driving forces of Integrated Treasury:

- I. Integrated Cash Flow Management allows banks to treat Rupee and foreign currency cash flows holistically.
- II. Interest Arbitrage enables banks to shift funds swiftly between domestic and global markets based on opportunities.
- III. Access to global resources is restricted to only those banks with physical overseas branches.
- IV. Corporate demand for high-end services requires the treasury to offer direct merchant business facilities.
- V. Managing currency and interest rate risks using derivatives is a key component of risk management.

Which combination of the statements is correct?

- (A) I, II, IV, and V only
- (B) I, II, III, and IV only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

18. (A) Trading Book

The trading book is specifically designed to record and manage proprietary positions taken by the treasury to generate profits. It includes unhedged currency balances and securities held for short-term gains from market movements. Unlike the merchant book, which focuses on customer transactions, or the asset-liability management book, the trading book actively tracks risks inherent in the bank's own trading activities.

19. (C) P-3, Q-4, R-2, S-1

Forward rate agreements help fix future interest rates for commercial paper. Credit default swaps offer protection against corporate bond defaults. Securitized assets involve pass-through certificates from special purpose vehicles. Triparty repos are used for short-term liquidity management to optimize returns. These diverse instruments allow an integrated treasury to manage liquidity, hedge various risks, and enhance overall profitability in the financial markets.

20. (B) The process of Globalisation

Globalisation in financial markets is characterized by the integration of domestic and international economies through increased capital flows. The surge in portfolio investments from foreign institutional investors highlights this connectivity. As markets become more integrated, domestic interest rates and asset prices are increasingly influenced by global trends and the movement of cross-border capital into emerging markets.

21. (C) P-4, Q-3, R-1, S-2

Leveraging involves conducting high volumes of business using relatively small capital. Speculation refers to buying or selling assets specifically to profit from price movements. Arbitrage is the practice of exploiting price imperfections across different markets simultaneously for gain. Emerging market countries are fast-developing, market-driven economies. Together, these concepts define the modern landscape of integrated treasury operations and global finance.

22. (D) The cost of hedging or the cost of risk.

Modern transfer pricing mechanisms go beyond historical interest costs by incorporating the cost of risk. This includes the expenses associated

with hedging market risks and the capital charge required for credit risk. By adding these elements, the treasury ensures that the internal cost of funds reflects the true economic cost, facilitating better risk management and more accurate profitability assessments.

23. (D) Over-The-Counter (OTC) Market - Trading customized derivative products like Forward Rate Agreements

The over-the-counter market is characterized by bilateral trades of customized financial instruments, such as forward rate agreements and interest rate swaps, rather than standardized contracts found on exchanges. Wholesale debt markets focus on large-scale government and corporate bond trading. Primary markets handle new security issuances. Equity markets involve stock trading, and credit default swaps are typically handled in specialized segments.

24. (B) Risk Adjusted Return On Capital (RAROC)

Risk Adjusted Return On Capital is a sophisticated model used by banks to measure profitability relative to the amount of risk taken. It helps in determining the appropriate capital allocation for various business activities, including treasury operations. By utilizing this framework, banks can graduate to superior risk management approaches and ensure that their returns are sufficient to cover potential losses.

25. (C) Managing risks inherent in proprietary positions - Merchant Book

The merchant book is dedicated to recording and managing transactions related to retail and corporate customers, such as foreign exchange for exporters. Conversely, risks inherent in proprietary positions, where the bank trades for its own profit, are managed within the trading book. The asset-liability management book handles internal liquidity and structural risks, while the trading book focuses on market-driven gains.

26. (A) The profit earned by simultaneously trading in different markets to exploit price imperfections.

Arbitrage is the practice of capitalizing on price discrepancies for the same or similar financial instruments across different markets. A treasury dealer executes simultaneous buy and sell orders to lock in a risk-free profit. This activity helps

but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2011

50. Which of the following best describes the primary role of the dealing room in a bank's treasury?
- (A) To execute buying and selling in various financial markets including foreign exchange, money markets, and securities.
(B) To verify deal slips, reconcile Nostro accounts, and guarantee settlement on value dates.
(C) To appraise the Asset-Liability Committee (ALCO) on total market risk exposures and adherence to prudential parameters.
(D) To exclusively conduct primary market credit appraisals for non-SLR corporate debt issues.

Oct/Nov 2019

51. Based on the arbitrage scenario where the swap premium yield is 4.17% and the offshore USD deposit yield is 0.15%, what is the total combined return the Forex Treasury achieves by executing the swap and placing the USD deposit abroad?
- (A) 3.65%
(B) 4.17%
(C) 4.32%
(D) 5.00%

May/June 2016

52. Which of the following best explains why the impact of capital inflows into an emerging market economy is not always benign?
- (A) They consistently force domestic inflation rates to remain artificially low, which prevents economic growth.
(B) Fluctuations in portfolio investments can cause severe volatility in prices, interest, and exchange rates.
(C) They mandate the immediate conversion of all existing commercial bank deposits into various foreign assets.
(D) They eliminate the necessity for domestic financial markets to maintain robust payment and settlement systems.

Oct/Nov 2022

53. Based on the scenario provided below, answer the following questions:

A large commercial bank is restructuring its treasury operations. It establishes a Dealing Room headed by the Chief Dealer, an independent Back-Office, and a newly formed Mid-Office reporting directly to the Head of Risk Management. During the first week of operations, a corporate dealer in the Front Office executes a large cross-currency swap for a major client. The trade exceeds the client's internal exposure limit. Simultaneously, the Back-Office detects a discrepancy in the confirmation document received from the counterparty bank.

Which division is explicitly responsible for independently verifying the authenticity of the confirmation document from the counterparty bank?

- (A) The Front Office
(B) The Mid Office
(C) The Back Office
(D) The Investment Department

May/June 2014

54. What is the most significant consequence of the integration of domestic financial markets with global markets for treasury operations?
- (A) Treasuries are strictly limited to utilizing only Rupee-denominated assets for all investment and lending.
(B) Treasuries must abandon traditional liquidity management roles to focus exclusively on domestic equity trading.
(C) Treasuries are legally prohibited from servicing corporate client demands for high-end derivative products.
(D) Treasuries can manage Rupee and foreign cash flows holistically, facilitating integrated interest arbitrage.

Oct/Nov 2013

55. In the same scenario, under the correct organizational structure, why is the corporate dealer not permitted to rectify the discrepancy in the settlement process directly?
- (A) Front Office staff are not trained in accounting software.
(B) Settlement discrepancies can only be resolved by the Asset-Liability Management (ALM) desk.
(C) Corporate dealers are solely responsible for

essential merchant services, including foreign exchange and advisory, to corporate customers, making the treasury a vital hub for both risk and profit.

- 36.** (B) To ensure independent compliance and objectively report total market risk to top management.

The mid-office is designed as a control function that monitors the activities of the front office dealers. By reporting to the head of risk management instead of the head of treasury, it maintains the independence necessary to objectively assess and report on market risk and limit compliance. This segregation prevents conflicts of interest and ensures that management receives unbiased risk information.

- 37.** (C) I, II, and III only

The back-office provides essential administrative and settlement support for treasury operations. Its duties include the independent confirmation of deals with counterparties, verification of documentation, and the completion of all accounting and regulatory reporting tasks. However, the monitoring of exposure and stop-loss limits is a risk management function that typically falls under the jurisdiction of the mid-office rather than the back-office.

- 38.** (D) The Investment Department handles them outside the Dealing Room to ensure proper credit risk appraisal.

Primary market corporate debt issues require specialized evaluation, including credit risk appraisal and legal documentation review. Because these tasks are time-consuming and differ from the fast-paced nature of secondary market trading, banks usually manage them through an investment department located outside the main dealing room. This ensures that long-term credit risks are thoroughly assessed before the bank commits capital.

- 39.** (D) I, II, and IV only

Interest arbitrage involves capitalizing on rate differences across various currencies and markets, such as borrowing in dollars to lend in rupees. The development of futures markets has expanded these opportunities by allowing treasuries to arbitrage between over-the-counter and exchange-traded markets. Furthermore,

banks are not prohibited from large-scale money market activities, provided they comply with regulatory limits and risk parameters.

- 40.** (B) The corporate demand for high-end services, requiring an integrated service from the bank.

Modern corporate clients require sophisticated financial services that span multiple market segments, such as currency hedging and interest rate swaps. An integrated treasury structure allows banks to provide these high-end services efficiently by managing various financial risks and products from a single, unified platform. This responsiveness to customer needs is a major catalyst for the consolidation of diverse treasury functions.

- 41.** (C) I, III, IV, and V only

Speculative trading aims for profit from price movements, while authorized dealers trade currencies within set limits. Treasuries also actively trade government securities and invest in securitized assets like pass-through certificates. However, the regulator in India does not currently permit commercial banks to engage in the short selling of equities, as this is restricted to maintain financial stability and market integrity.

- 42.** (A) The treasury operates with zero autonomy and shares a unified accounting system with retail branches.

Bank treasuries typically require a high degree of operational autonomy and specialized accounting systems to handle complex financial transactions. Many banks prefer a specialized branch structure because it allows for independent books of accounts and direct participation in global settlement systems. A setup with zero autonomy and shared retail branch accounting would be inefficient for high-volume, time-sensitive treasury operations.

- 43.** (D) I, III, and V only

Liquidity management involves meeting reserve requirements across currencies, while risk management addresses balance sheet mismatches. The trading book is specifically used to manage the risks associated with the bank's own proprietary positions. In contrast, proprietary trading is done for profit rather than just hedging, and the merchant book is used

May/June 2021

8. Consider the following statements about the Rediscounting of Foreign Bills:
- It is an inter-bank advance where Treasury refines the foreign currency bills negotiated by another bank.
 - It is a Treasury product, as the bills are rediscounted without recourse to the bank.
 - The bill-rediscounting is generally priced higher than money market placements due to the usance period.
- Which of the above statement(s) is/are correct?
- I and II only
 - I and III only
 - II and III only
 - I, II, and III

Oct/Nov 2015

9. Up to what percentage of their respective Net Demand and Time Liabilities (NDTL) can eligible entities avail overnight funds under the Marginal Standing Facility (MSF) after the enhanced pandemic limit was withdrawn?
- 1%
 - 2%
 - 3%
 - 4.25%

May/June 2007

10. Consider the following statements regarding External Commercial Borrowings (ECB):
- Indian companies can borrow in global markets to fund domestic or overseas projects within RBI guidelines.
 - Eligible borrowers can borrow up to USD 750 mn depending on the sector, without prior approval of RBI.
 - The exchange risk in an ECB is borne by the overseas lending institution.
- Which of the above statement(s) is/are correct?
- I and II only
 - II and III only
 - I and III only
 - I, II, and III

Oct/Nov 2024

11. What is the underlying financial mechanism when a bank enters into a reverse repo transaction?
- The bank purchases securities using surplus cash, earning interest on secured lending while holding securities eligible for SLR

compliance.

- The bank borrows funds by selling its securities with a commitment to repurchase them at a pre-agreed price.
- The bank issues short-term debt paper to corporates to meet temporary cash flow mismatches.
- The bank borrows foreign currency to finance export credit at a discounted rate.

May/June 2019

12. Consider the following statements regarding prudential limits in money markets:
- For Scheduled Commercial Banks, the limit for borrowing in Call and Notice Money is 100% of capital funds on a daily average basis in a reporting fortnight.
 - For Primary Dealers, the limit for borrowing in Term Money is 225% of Net Owned Fund as at the end of the previous financial year.
 - For Co-operative Banks, the limit for borrowing in Call, Notice, and Term Money is 2.0% of aggregate deposits as at the end of the previous financial year.
 - Payment Banks have different prudential borrowing limits than Regional Rural Banks.

Which of the above statement(s) is/are correct?

- I, II, and III only
- I, III, and IV only
- II, III, and IV only
- I, II, III, and IV

Oct/Nov 2006

13. How does a bank conceptually earn interest on idle funds parked in a Nostro account that normally does not earn any interest?
- By transferring the balances directly to a local Exchange Earners' Foreign Currency Account held in India.
 - Via an automatic sweep where the correspondent bank invests excess funds overnight in the money market.
 - By entering into a complex bill rediscounting agreement with the designated correspondent bank overseas.
 - By issuing short-term commercial paper against the unutilised balance maintained in the Nostro account.

fifteen percent from the offshore dollar deposit. Combining these two independent sources of income results in a total annualized yield of four point three two percent.

- 52.** (B) Fluctuations in portfolio investments can cause severe volatility in prices, interest, and exchange rates.

Large capital inflows into emerging markets can create economic challenges despite supplementing domestic capital. Significant shifts in portfolio investment by foreign institutional investors often lead to volatility in exchange rates, interest rates, and asset prices. This unpredictability can strain the domestic financial system and complicate the central bank's efforts to maintain economic stability and manage monetary policy effectively.

- 53.** (C) The Back Office

The back-office is specifically responsible for the administrative and settlement phases of treasury transactions. This includes the independent verification of deal authenticity by checking confirmation documents received from counterparties against the bank's internal deal slips. This process ensures that all trades are accurately recorded and that both parties agree on the terms before final settlement and payment occur on the value date.

- 54.** (D) Treasuries can manage Rupee and foreign cash flows holistically, facilitating integrated interest arbitrage.

Global integration allows treasuries to view domestic and foreign currency cash flows as a unified pool of liquidity. This holistic approach enables banks to switch funds between markets to exploit interest rate differentials and arbitrage opportunities. It also allows them to offer more sophisticated risk management products to corporate clients who operate in multiple currencies, thereby enhancing both efficiency and overall profitability.

- 55.** (D) Regulatory mandates require strict segregation between deal execution and deal settlement to avoid financial loss and defaults. To prevent fraud and operational errors, regulatory guidelines mandate a strict segregation of duties between those who execute trades and those who settle them. If dealers were allowed to handle the

settlement process, there would be a significant risk of unauthorized transactions being hidden. Keeping the back-office independent ensures that all discrepancies are identified and resolved through a transparent and controlled process.

- 56.** (B) I, II, III, IV

A treasury transaction begins with the execution of the deal by a dealer in the front office. Once finalized, deal slips are prepared to document the transaction details. The back-office then independently confirms the trade with the counterparty to ensure accuracy. Finally, the transaction is settled, involving the actual movement of funds or securities on the specified value date.

- 57.** (C) Speculation / Trading

When a treasury intentionally leaves a currency position un-squared overnight, it is taking a market risk based on the expectation of future price movements. This activity is defined as speculation or proprietary trading. The goal is to generate profit from the change in exchange rates, which is distinct from routine liquidity management or the hedging of customer-related transactions within the bank.

- 58.** (A) P-2, Q-1, R-3, S-4

The asset-liability management book handles liquidity and internal risks, while the merchant book manages client-related currency transactions. The trading book is used for proprietary positions aimed at generating profit from market movements. Nostro accounts are foreign currency accounts held with correspondent banks abroad. Together, these records allow the treasury to track its diverse functional responsibilities and maintain clear financial oversight.

- 59.** (D) Overseas Direct Investment and global Mergers & Acquisitions.

Outward remittances by domestic companies to acquire or invest in foreign entities are classified as overseas direct investment. This represents a significant capital account transaction where a resident company expands its operations internationally through mergers and acquisitions. This route is part of the broader capital flow mechanism allowed under liberalized exchange

for client transactions, not the asset-liability management book.

44. (D) It monitors exposure limits, stop loss limits, and implements the Transfer Pricing Mechanism. The back-office is primarily responsible for the administrative aspects of treasury transactions, including deal confirmation, settlement, and account reconciliation. Monitoring exposure and stop-loss limits is a risk control function assigned to the mid-office. Similarly, the implementation of the transfer pricing mechanism is usually a mid-office or management task, ensuring that risk monitoring remains independent from the back-office settlement operations.

45. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Structuring a treasury as a specialized branch is advantageous because it facilitates the maintenance of separate books of accounts and specialized reporting. This independent setup allows the treasury to act as an Authorised Dealer, directly interfacing with clearing and settlement platforms. Such a functional arrangement is more efficient for managing high-value, global financial transactions than a standard head office department structure.

46. (B) Originating retail mortgage loans for individual banking customers.

An integrated treasury focuses on wholesale financial activities, including managing cash and statutory reserves, optimizing profits through trading, and assisting in asset-liability management. It also provides specialized merchant services for corporate clients. However, the origination of retail mortgage loans for individual customers is a function of the bank's retail or consumer banking division and is outside the scope of treasury.

47. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The mid-office performs critical risk monitoring functions that must remain objective and free from the influence of the trading desk. By reporting to the head of the risk management department rather than the head of treasury, the mid-office can independently track exposure limits and

prudential compliance. This organizational structure is essential for maintaining effective internal controls and providing accurate risk reporting.

48. (A) Treasury requires high capital allocation due to the immense credit risk found in inter-bank markets.

Treasury requires relatively low capital allocation due to the minimal credit risk found in inter-bank markets. Treasury operations are attractive because they are highly leveraged and require relatively low capital allocation compared to retail banking. Most treasury transactions occur in inter-bank markets, where credit risk is minimal. Profitability is driven by the ability to process massive transaction volumes with narrow spreads and lower operational costs than those associated with maintaining a large retail branch network.

49. (C) Assertion (A) is true, but Reason (R) is false.

The risk management function in a bank is comprehensive, overseeing assets and liabilities across all maturity stages to ensure long-term stability. While the treasury department primarily handles short-term funds-flow and liquidity, typically with maturities of less than one year, it is incorrect to suggest that treasury only deals with long-term flows. Treasury activity is fundamentally centered on short-term market operations.

50. (A) To execute buying and selling in various financial markets including foreign exchange, money markets, and securities.

The dealing room, or front office, is the operational heart of the treasury where professional dealers execute trades in foreign exchange, money markets, and securities. Its primary goal is to manage the bank's liquidity and take profitable positions within established risk limits. Verification, settlement, and risk reporting are handled by the back and mid-offices to ensure a proper division of duties.

51. (C) 4.32%

The total return from an arbitrage operation is the sum of the annualized yields from each component. In this case, the treasury earns a four point one seven percent yield from the USD/INR swap premium and an additional zero point

- 68.** (C) Both statements are correct
Banks generally avoid maintaining large open positions solely for merchant business, preferring to square these transactions to minimize risk. Any residual open position at the end of the day exposes the bank to significant exchange risk, as currency values can fluctuate overnight. Therefore, treasuries carefully monitor and limit these positions to protect the bank from adverse movements in international currency markets.
- 69.** (C) Rs. 50 million
Treasury operations involve high-value transactions conducted in wholesale markets. To ensure operational efficiency and cost-effectiveness, specialist staff typically handle trades with a minimum size of fifty million rupees. This large transaction scale distinguishes treasury activities from retail banking operations, where transaction amounts are much smaller and more numerous, requiring different processing systems and management approaches for efficiency and risk control.
- 70.** (A) I and II only
Globalisation has led to domestic interest rates being influenced by international capital flows and the emergence of new market structures like clearing corporations. These institutions provide the necessary infrastructure for stable and efficient trading. However, rupee derivatives like swaps and options are not banned; they are essential tools used by treasuries to manage interest rate and currency risks in an integrated environment.
- 71.** (B) 100% of unimpaired tier-1 capital, or USD 10 million, whichever is higher.
The Reserve Bank of India permits banks to access foreign currency funds through their overseas branches or correspondents up to a specified limit. This limit is set at one hundred percent of the bank's unimpaired tier-one capital or ten million US dollars, whichever is higher. This regulatory framework allows banks to manage their foreign currency liquidity while ensuring they do not over-leverage.
- 72.** (B) II and III only
Forward rate agreements and interest rate swaps are vital treasury products used by corporates to hedge interest rate risks on future issuances or existing loans. While these derivatives can be used for speculation, their primary corporate use is risk management. It is incorrect to state that large corporates never use them for hedging, as managing financial exposure is their main purpose.
- 73.** (C) From a strict compliance and service centre to an active profit centre with proprietary trading and investment activity.
Economic reforms in the 1990s transformed the role of bank treasuries from passive service units focused on statutory compliance into dynamic profit centres. Modern treasuries now engage in active proprietary trading, investment, and arbitrage across diverse financial markets. This shift has allowed banks to capitalize on market volatility and generate significant non-interest income while continuing to manage the bank's overall liquidity.
- 74.** (A) II and III only
Treasury operations are efficient because they involve very large transaction sizes with low relative operational costs. Profits are primarily generated from high-volume business and narrow spreads rather than high capital allocation. In fact, treasury activity is highly leveraged and typically requires less capital than traditional retail banking, making the high return on allocated capital an attractive feature for commercial banks.
- 75.** (D) The ALM Book manages internal risk and liquidity mismatches, while the Trading Book manages risks inherent in proprietary positions.
The asset-liability management book is dedicated to managing the bank's internal liquidity and structural interest rate risks arising from maturity mismatches. In contrast, the trading book is used to manage the risks of proprietary positions held for profit from market price movements. This distinction ensures that the bank's core stability functions are managed separately from its more speculative trading activities.
- 76.** (D) I, II, and III only
A typical bank treasury is headed by a senior officer and consists of three main divisions: the front office for dealing, the mid-office for risk, and the back-office for settlement. Specialized branches offer direct access to foreign exchange

clearing systems. However, the mid-office does not handle deal verification or settlement; those administrative duties are the specific responsibility of the back-office.

overseas branches, as modern technology and correspondent banking allow for widespread participation.

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- 77.** (C) Treasury handles short-term flows under one year, while risk management covers all asset maturities.

Treasury operations primarily manage short-term financial flows, focusing on maturities of less than one year. This includes overnight lending and short-dated securities. Conversely, the risk management function has a broader mandate, covering the bank's entire asset and liability portfolio across all maturity spectrums. This ensures that both immediate liquidity needs and long-term structural risks are appropriately monitored and mitigated.

- 78.** (B) I, III, and IV only

The mid-office is a critical risk and compliance unit that provides essential management information and appraises the asset-liability committee on prudential risk compliance. It also supports functions like transfer pricing and liquidity management analysis. Importantly, it does not execute trades; the actual buying and selling of assets is performed by professional dealers in the front office.

- 79.** (A) Domestic interest rates are influenced by global interest rate trends due to cross border capital flows.

As financial markets become more integrated, domestic interest rates are increasingly affected by global trends and the flow of international capital. When global rates change, capital may move between countries to seek higher returns, which in turn impacts domestic liquidity and rates. While domestic factors remain important, they are no longer insulated from broader macroeconomic shifts occurring in international financial markets.

- 80.** (A) I, II, IV, and V only

Integrated treasury operations are driven by the need for holistic cash flow management and the opportunity for interest arbitrage across markets. Corporate demand for specialized services and the use of derivatives for risk management also play central roles. Furthermore, access to global resources is not limited to banks with physical

CHAPTER 20

Treasury Products

Oct/Nov 2022

1. Why does Omega Bank include corporate debentures in its investment portfolio despite them carrying a higher credit risk than G-Secs?
- (A) Because corporate debentures are fully guaranteed by the government.
- (B) Because yields on corporate bonds and debentures are higher than the yield on government securities.
- (C) Because they are mandatory to fulfil the Cash Reserve Ratio (CRR).
- (D) Because corporate debentures have no secondary market, ensuring price stability.

May/June 2005

2. Which of the following pairs regarding liquidity facilities is incorrectly matched?
- (A) Marginal Standing Facility (MSF) – Allows borrowing up to 2% of respective NDTL.
- (B) Cash Management Bills (CMBs) – Issued for maturities less than 91 days.
- (C) Standing Deposit Facility (SDF) – Minimum bid size is Rupees one lakh.
- (D) Tripartite Repo Trades (TREPS) – Minimum and maximum tenors are one day to one year.

Oct/Nov 2011

3. What is the process of valuing any financial asset or liability at current market rates known as?
- (A) Marking to Market
- (B) Securitisation
- (C) Yield to Maturity
- (D) Dematerialisation

May/June 2024

4. Consider the following statements regarding Commercial Paper (CP):
- I. The issuing company should have a minimum credit rating of 'A3' as per SEBI guidelines.
- II. The issue of CP should be for a minimum amount of Rs. 5 lacs and multiples thereof.
- Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2018

5. Which of the following defines an EEFC account?
- (A) A current account denominated in foreign currency, maintained by banks with their correspondent banks.
- (B) A foreign currency deposit denominated in foreign currency maintained by non-resident Indians with banks in India.
- (C) An electronic account maintained by the Public Debt Office of the Reserve Bank of India for government securities.
- (D) A foreign currency account where exporters are allowed to hold up to 100% of export proceeds without earning interest.

May/June 2013

6. Consider the following statements regarding the Standing Deposit Facility (SDF):
- I. Deposits under the SDF are reckoned as balances eligible for the maintenance of the Cash Reserve Ratio (CRR).
- II. Deposits under the SDF are eligible assets for the maintenance of the Statutory Liquidity Ratio (SLR).

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2009

7. For spot trades in the foreign exchange market, on which day does the settlement of payment and receipt of funds take place?
- (A) On the same day.
- (B) On the next working day.
- (C) Two working days from the trade date.
- (D) Three working days from the trade date.

management rules to support the global growth of domestic corporations.

60. (D) P-1, Q-2, R-3, S-4

The Clearing Corporation of India Limited manages a settlement guarantee fund to prevent defaults. The National Securities Depository Limited maintains demat accounts for electronic security storage. The Reserve Bank of India sets exposure limits for banks in the capital market. The Securities and Exchange Board of India regulates mutual funds and investment institutions, ensuring overall market integrity and protection for investors.

61. (C) Sudden portfolio shifts increase volatility in prices and rates, making the economy vulnerable. Central banks monitor capital inflows because rapid shifts in foreign portfolio investments can cause significant instability. Large-scale movements of capital into or out of a country can lead to sharp fluctuations in the exchange rate and domestic interest rates. This volatility makes the economy vulnerable to external shocks, necessitating regulatory oversight to maintain financial stability and ensure that markets function orderly.

62. (B) Merchant Business - Earning from the buy-sell spread of foreign currency
Merchant business generates profit through the spread between the rates at which a bank buys and sells foreign currency to its customers. This is a traditional and stable source of treasury income. Interest arbitrage involves exploiting rate differentials across markets, while equity trading and transfer pricing serve different strategic roles related to market gains and the internal allocation of fund costs.

63. (A) Profit centre

When the treasury acts as a central funding hub and adds a margin to the internal transfer price, it is operating as a profit centre. This allows the treasury to generate earnings from managing the bank's pool of funds and risks. This approach encourages efficiency and ensures that the treasury is evaluated based on its ability to contribute to the bank's overall profitability.

64. (A) Open position - Credit risk due to counterparties defaulting on primary debt

An open position is fundamentally associated with exchange risk, which arises from the potential for currency value fluctuations, not credit risk. Credit risk relates to the possibility of a counterparty defaulting on its financial obligations. Proprietary trading and short selling are speculative activities aimed at profiting from price movements, whereas the term open position specifically describes a bank's net currency exposure.

65. (B) The integration of domestic and global markets through free capital flows and minimal regulation.

Globalisation refers to the increasing interconnectedness of national financial markets with the global economy. This process is driven by the liberalization of capital accounts, allowing for freer movement of funds across borders. As a result, domestic interest rates and asset prices become more sensitive to international trends, requiring treasuries to manage risks and opportunities on a global scale rather than in isolation.

66. (A) Only Statement I is correct

It is a fundamental requirement of internal control that the front office and back office are completely segregated and report to different managers. This separation prevents fraud and ensures independent verification of deals. However, the mid-office is a risk management unit that should remain independent of the trading desk and should not be involved in the day-to-day execution of trades.

67. (C) Financial instruments like bonds and currencies that are primarily traded in electronic form.

Tradable assets are financial instruments that can be easily bought and sold in organized markets. These include government bonds, corporate debentures, currencies, and various derivative products. Unlike fixed physical assets or illiquid loans, these instruments are typically held in electronic form and are characterized by high liquidity, allowing treasury departments to adjust their positions quickly in response to changing market conditions.

May/June 2025

14. Consider the following statements about Tripartite Repo Trades (TREPS):

- I. CCIL acts as a tri-party agent between the two parties to facilitate collateral selection and settlement.
- II. Members desirous of concluding deals in TREPS need to seek membership from CCIL and Clear Corp Dealing Systems (India) Ltd.
- III. CCIL provides Novation facility and becomes the common counterparty to both parties.
- IV. Initial Margin is collected exclusively in the form of securities; cash is not permitted.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2014

15. Which of the following statements is correct regarding Treasury Bills?

- (A) They are issued by State Governments to meet their temporary cash flow mismatches and seasonal requirements.
- (B) They are issued for standard maturities of 91-days, 182-days, 364-days, and sometimes 728-days for liquidity.
- (C) They are priced significantly above face value and pay a fixed interest coupon to the investor annually.
- (D) Their price is determined through an auction process where banks and primary dealers are the main participants.

May/June 2012

16. Consider the following regarding interaction between domestic and global markets:

- I. Foreign institutional investors mainly invest in direct long-term projects rather than portfolio investments.
- II. Holders of ADRs/GDRs have an option to sell their holdings in domestic markets and receive proceeds in foreign currency.
- III. Banks can use their FCNR deposit funds for investment in overseas markets.
- IV. Exporters can receive pre-shipment and post-shipment finance in foreign currency.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only

(C) I, III, and IV only

(D) I, II, III, and IV

Oct/Nov 2020

17. Which of the following correctly describes the distinction between debentures and bonds in the domestic market?

- (A) Debentures are governed solely by the law of contracts, whereas bonds are strictly governed by the Companies Act.
- (B) Debentures are governed by Company Law and require registration, while bonds are negotiable instruments under contract law.
- (C) Bonds issued by public sector companies implicitly carry a full government guarantee under all financial circumstances.
- (D) There is a strict functional difference in the international market regarding currency convertibility for bonds and debentures.

May/June 2010

18. Consider the following statements regarding Market Repo:

- I. Repo is used for lending and borrowing money market funds for terms extending from 1 day to 1 year.
- II. The principal amount exchanged against securities is lower than the market value of securities by a margin called 'hair cut'.
- III. Funds borrowed under repo in government securities are exempted from CRR/SLR computation.
- IV. Borrowings through repo in corporate bonds are reckoned as liabilities for CRR/SLR requirement.
- V. Participants are allowed to borrow against the collateral of their own securities.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2017

19. Which of the following statements regarding Cash Management Bills (CMBs) is incorrect?

- (A) The Non-Competitive Bidding Scheme for Treasury Bills is extended to CMBs.
- (B) CMBs are non-standard, discounted instruments issued for maturities less than 91 days.
- (C) The settlement of the auction for CMBs is

on a T+1 basis.

- (D) Investment in CMBs is reckoned as an eligible investment in Government Securities by banks for SLR purpose.

May/June 2018

20. Consider the following statements regarding Treasury Bills:

- I. They are issued for pre-determined amounts at a discount to the face value.
- II. Currently, 91-day T-bills are issued weekly on each Wednesday.
- III. The 182-day T-bill is issued fortnightly on Wednesday preceding the non-reporting Friday.
- IV. Individuals are restricted to a maximum of 10 percent of the notified amount under non-competitive bidding.
- V. They are held in electronic form in a SGL account.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, II, III, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2012

21. Which of the following statements regarding Equities is incorrect?

- (A) Preference share capital enjoys a preferential right with respect to dividend payment and return of capital on winding up.
- (B) Section 55(i) of the Companies Act 2013 prohibits the issue of any preference share that is irredeemable.
- (C) Preference shares can be cumulative or non-cumulative in nature.
- (D) Banks' capital market exposures are capped at not exceeding 50% of the paid-up share capital of the investee company.

May/June 2015

22. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options given below:

Assertion (A): Forward exchange rates do not reflect the forecasted or projected rate movements in the market.

Reason (R): Forward exchange rates are mechanically arrived at by adding or deducting the risk-free interest rate differentials of two

currencies from the spot exchange rate.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2008

23. Preference share capital can be classified into various types. Which of the following is NOT one of the classifications mentioned?

- (A) Cumulative or non-cumulative
- (B) Secured or unsecured
- (C) Participating or non-participating
- (D) Redeemable or irredeemable

May/June 2023

24. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options given below:

Assertion (A): The yield on government bonds and the price of the bonds move in the opposite direction.

Reason (R): When the prevailing risk-free interest rate rises above the fixed coupon rate of a bond, its price must fall to offer an equivalent competitive yield to new buyers.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2019

25. Futures and options can be based on various underlying assets. Which of the following is NOT explicitly mentioned as a potential underlying asset for an options contract?

- (A) Real estate properties
- (B) Physical commodities like wheat and gold
- (C) Equity stocks
- (D) Stock indices

May/June 2011

26. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options given below:

Assertion (A): Mutual funds and financial institutions are key lenders in the call money market alongside scheduled commercial banks.
Reason (R): Non-bank players were phased out of the call money market with effect from 6 August 2005, making it purely an inter-bank market.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2025

27. What is the most appropriate reason for market agents to utilise the Non-Deliverable Forwards (NDF) market?

- (A) To hedge currency risks and speculate on restricted currencies that face regulatory barriers in onshore markets.
(B) To obtain physical delivery of fully convertible global currencies for making standard import payments.
(C) To participate in the overnight call money market without the need for maintaining CRR and SLR.
(D) To invest foreign exchange surpluses directly into high-yield sovereign bonds of emerging Asian economies.

May/June 2016

28. Read the following scenario and answer the question that follows:

Alpha Bank holds a surplus of USD funds and identifies an investment opportunity in a 3-month Rupee-denominated Commercial Paper (CP). The bank executes a swap by selling USD at the spot rate and simultaneously buying back the USD 3 months forward to fund the CP.

In the context of the transaction described, how is the effective cost of the USD funds calculated over the 3-month period?

- (A) It consists purely of the interest earned on the Commercial Paper.

- (B) It is the difference between the CP yield and the overnight MIBOR.
(C) It consists of the interest at the market rate plus the forward premium for the 3-month period.
(D) It is equivalent to the yield to maturity of a 91-day Treasury Bill.

Oct/Nov 2013

29. Which of the following best describes the role of the Clearing Corporation of India Ltd. (CCIL) in Tripartite Repo Trades (TREPS)?

- (A) It issues government securities and corporate bonds directly to the borrowing members.
(B) It acts as a tri-party agent providing novation facility, collateral selection, and settlement services while collecting initial margins.
(C) It acts as a primary dealer to bid for Treasury Bills in the non-competitive bidding scheme.
(D) It dictates the policy repo rate and marginal standing facility rate based on the collateral selected.

May/June 2009

30. Read the following scenario and answer the question that follows:

Beta Bank has surplus cash of Rs. 10 Crores. The treasury manager decides to park the surplus funds with the RBI using the Automated Sweep-In and Sweep-Out (ASISO) facility under the Standing Deposit Facility (SDF). The policy repo rate currently stands at 5.40%.

At what interest rate will Beta Bank earn returns on the Rs. 10 Crores parked under the Standing Deposit Facility (SDF)?

- (A) 5.40%
(B) 5.65%
(C) 5.15%
(D) 4.25%

Oct/Nov 2021

31. Why do bank treasuries generally exercise caution when investing surplus funds in the domestic equity market?

- (A) Because equities are not traded on electronic platforms, leading to potential settlement delays and risks.
(B) Because dividend income from equities is subject to a 100% statutory liquidity ratio requirement by law.
(C) Because foreign institutional investors

- (B) It can be issued for a maturity period ranging from 1 day to 3 years.
- (C) It is a secured debt instrument backed by the floating assets of the issuing corporate.
- (D) Banks are permitted to invest in CP only if it is issued in physical promissory note form.

Oct/Nov 2014

57. Consider the following statements regarding Cash Management Bills (CMBs):

- I. They are non-standard, discounted instruments.
- II. They are issued for maturities exceeding 91 days.
- III. The settlement of the auction is on a T+1 basis.
- IV. They qualify for ready forward facility (Repo).
- V. Investment in CMBs is reckoned as an eligible investment for SLR purpose.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) I, III, IV, and V only
- (C) II, III, IV, and V only
- (D) I, II, IV, and V only

May/June 2012

58. Identify the incorrect statement regarding options contracts.

- (A) An American style option can be exercised by the buyer anytime between the day of purchase and the day of its expiry.
- (B) A Call option gives the holder the obligation to buy the specified quantity of the underlying asset at the strike price.
- (C) A European style option can only be exercised on the expiration day and not any time before that.
- (D) The seller of a Put option has the obligation to buy the underlying asset if the buyer decides to exercise the option.

Oct/Nov 2020

59. Consider the following statements regarding Debentures and Bonds:

- I. In domestic markets, debentures are transferable only by registration.
- II. Structured obligations can include put/call or convertibility options.
- III. Deep discount bonds pay interest periodically during the lock-in period.
- IV. Convertible debentures can be converted

into equity as per terms of issue.

- V. Section 42 of the Companies Act 2013 and relevant rules cap the number of investors in each tranche of private placement at 50/200.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, II, IV, and V only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

May/June 2010

60. Identify the incorrect statement concerning Certificates of Deposit (CD).

- (A) Financial institutions can issue CDs for a period not less than 1 year and not exceeding 3 years.
- (B) CDs are issued in demat form and the minimum amount of deposit for banks is Rs. 5 lacs and multiples thereof.
- (C) Banks can sanction loans against CDs and permit premature closure of CDs.
- (D) Banks must maintain CRR and SLR on the issue price of the CDs.

Oct/Nov 2017

61. Consider the following statements regarding different types of bonds:

- I. Zero coupon bonds are issued at a price much lower than face value.
- II. Floating rate bonds have coupons linked to a benchmark reset periodically.
- III. Period bonds are issued with redemption in instalments over a period.
- IV. Collateralised obligations are exclusively secured by real estate mortgages.
- V. Bonds with a put/call option often have step-up coupons to incentivize early redemption.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V only
- (B) I, II, IV, and V only
- (C) I, III, IV, and V only
- (D) II, III, IV, and V only

May/June 2018

62. All of the following are features of Cash Management Bills (CMBs), EXCEPT:

- (A) They are issued at a discount to the face value through auctions.
- (B) They are tradable and qualify for ready forward facility.
- (C) They are issued for standard maturities of

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by commercial banks.

Oct/Nov 2007

37. Match the regulatory/institutional bodies in List I with their respective functions/domains in List II:

List I: (Regulatory/Institutional Bodies)

- P. FBIL
- Q. CCIL
- R. SEBI
- S. FIMMDA

List II: (Functions/Domains)

1. Regulator of the Indian stock market and issuer of guidelines for investor protection.
 2. Replaced CBLO with TREPS and acts as a tri-party agent.
 3. Tasked with publishing benchmark MIBOR, Market Repo Overnight Rates, and T Bill curve.
 4. Prescribes market practices governing the issue of commercial paper.
- (A) P-3, Q-2, R-1, S-4
 - (B) P-1, Q-3, R-4, S-2
 - (C) P-4, Q-1, R-2, S-3
 - (D) P-2, Q-4, R-3, S-1

May/June 2017

38. Read the following scenario and answer the question that follows:

Delta Manufacturing has issued a Commercial Paper (CP) and later decides it wants to retire the debt early by buying back the issued paper.

If Delta Manufacturing decides to buy back the issued CP, what condition must be met?

- (A) The buyback must occur within the first 15 days of issue to ensure regulatory compliance.
- (B) The buyback must be handled through a private arrangement with the original paying agent.
- (C) The CP should not be bought back before a minimum period of 30 days from its issue.
- (D) The buyback must be approved by the Reserve Bank of India's Public Debt Office in advance.

Oct/Nov 2023

39. Which of the following is correctly paired regarding options?
- (A) European option – Can be exercised anytime between the purchase day and expiry day.
 - (B) Short Call – The seller has the obligation

to sell the underlying asset if the buyer exercises the option.

- (C) Long Put – Gives the holder the obligation to buy the underlying asset at the strike price.
- (D) Short Put – Gives the holder the right to sell the underlying asset on or before the expiry date.

May/June 2022

40. Read the following scenario and answer the question that follows:

Omega Bank maintains a portfolio of G-Secs, a portion of which is actively traded. The treasury noticed that G-sec yields in the market started rising due to inflation fears.

As the G-sec yields in the market rise, what immediate impact will this have on the price of the G-Secs held in Omega Bank's actively traded portfolio?

- (A) The price of the bonds will fall.
- (B) The price of the bonds will rise proportionally.
- (C) The face value of the bonds will be reduced by the RBI.
- (D) The coupon rate of the existing bonds will automatically increase.

Oct/Nov 2010

41. Which of the following pairs concerning the maturity periods of money market instruments is incorrectly matched?

- (A) Commercial Paper – Minimum 30 days and maximum 1 year
- (B) Call Money – Overnight placement
- (C) Notice Money – Between 2 days and 14 days
- (D) Term Money – Between 15 days and 1 year

May/June 2008

42. Which of the following best defines a foreign exchange swap transaction?

- (A) An agreement to buy or sell an asset for a certain price at a certain time on an exchange.
- (B) A combination of spot and forward transactions, or a combination of two forward transactions.
- (C) A contract giving the buyer the right, but not the obligation, to buy a specified quantity of underlying assets.
- (D) An overseas short-term investment in instruments of high credit quality issued by

Under which accounting category should Omega Bank classify the government securities that it holds mainly for investment purposes and not for trading?

- (A) Available for Sale (AFS)
- (B) Held for Trading (HFT)
- (C) Marked to Market (MTM)
- (D) Held to Maturity (HTM)

May/June 2017

80. Which of the following is correctly paired regarding preference share capital?

- (A) Their rights to claim dividends lapse automatically whenever the company does not record a profit.
- (B) They are strictly prohibited from being issued under Section 55 of the Companies Act, 2013 regulations.
- (C) They are subject to the fulfillment of various conditions laid down in Section 55 of the Companies Act.
- (D) They have a right to participate in surplus funds after equity capital is paid during winding up.

differentials between two countries.

- (B) They are determined purely by the immediate demand and supply of the foreign currency in the forward tenor.
- (C) They are based on interest rate differentials of two currencies added to or deducted from the spot rate.
- (D) They are forecasted using the overnight Mumbai Interbank Offered Rate as a primary benchmark for calculation.

Oct/Nov 2015

51. Consider the following statements about the Liberalised Remittance Scheme (LRS):

- I. Individuals are permitted to remit overseas up to USD 2,50,000 in a financial year without RBI approval.
- II. The remittance can be used for any purpose, including gambling and margin trading.
- III. Banks should not extend any credit facility to the customer for the purpose of making remittance under LRS.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2007

52. Why do Non-Deliverable Forwards (NDF) markets operate in offshore destinations and settle only in cash?

- (A) They involve the physical delivery of major global currencies like USD and EUR outside the domestic borders.
- (B) They are designed for retail investors who lack the capacity to take physical delivery of underlying commodities.
- (C) They are specifically used by central banks to conduct open market operations anonymously in global financial centers.
- (D) They allow hedging for currencies that are not fully convertible without requiring physical delivery of the domestic currency.

Oct/Nov 2024

53. Consider the following features related to Futures contracts:

- I. A futures contract is traded over the counter.
- II. Initial and Variable margins are to be maintained with the exchange.
- III. Physical delivery of futures contracts is

minimal and positions are normally closed out by opposite trades.

IV. Counter party risk is absent as the futures exchange guarantees the settlement.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

May/June 2019

54. Which of the following statements correctly describes a feature of the foreign exchange market?

- (A) It is a highly regulated market with strict physical boundaries limiting trading to specific national stock exchanges.
- (B) Two-way quotes are offered sequentially, with a wide buy-sell spread indicating high market liquidity.
- (C) It is an easily liquifiable market that remains open 24 by 7, offering the largest trading volume in the world.
- (D) Settlement in the spot market always occurs on the same day the trade is executed.

Oct/Nov 2006

55. Consider the following statements about Capital Market Exposures:

- I. Bank treasuries are generally leading investors in stock markets due to low volatility.
- II. Banks' capital market exposures are capped at not exceeding 30% of the Share Capital of the investee company.
- III. At the portfolio level, direct exposure by way of investments is capped at 20% of Net Worth.
- IV. Guarantees issued to Stock Brokers are considered an example of indirect exposure to Capital Market.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

May/June 2025

56. Identify the correct statement regarding Commercial Paper (CP).

- (A) Every issue and renewal of a CP is treated as a fresh issue.

have a monopoly over the operations of the National Stock Exchange.

- (D) Because of high volatility and regulatory ceilings prescribed by the RBI on capital market exposures.

May/June 2006

32. Read the following scenario and answer the question that follows:

Beta Bank faces a temporary shortfall and considers borrowing funds under the Liquidity Adjustment Facility (LAF) by pledging government securities.

When Beta Bank faces a shortfall and borrows under the LAF, what transaction does it execute with the RBI?

- (A) A Reverse Repo transaction where it buys securities from the RBI.
 (B) A discount of foreign bills with the RBI.
 (C) An outright sale of government securities in the secondary market without any repurchase agreement.
 (D) A Repo transaction where it sells government securities to the RBI with a commitment to repurchase them.

Oct/Nov 2005

33. Arrange the following foreign exchange spot-related delivery terms in chronological order from the earliest settlement to the latest:

- I. SPOT
 II. TOD (Cash)
 III. TOM
 (A) II, III, I
 (B) I, II, III
 (C) II, I, III
 (D) III, II, I

May/June 2020

34. Read the following scenario and answer the question that follows:

Gamma Imports Ltd. enters a forward contract with its bank to cover EUR currency risk. To cover this customer exposure, the bank's treasury takes an opposite position in the market.

How does the bank's treasury neutralise the risk originating from the forward contract entered with Gamma Imports Ltd.?

- (A) By holding the foreign currency in a Nostro account.
 (B) By purchasing a deep discount corporate bond.

- (C) By taking a reverse/opposite position in the inter-bank market.

- (D) By investing the equivalent Rupee amount in Cash Management Bills.

Oct/Nov 2016

35. Match the Treasury product terms in List I with their descriptions in List II:

List I: (Treasury Product Terms)

- P. SGL Account
 Q. Nostro Account
 R. EEFC Account
 S. LRS

List II: (Descriptions)

1. Accounts meant for exporters to hold up to 100% of export proceeds in foreign currency.
 2. Scheme allowing individuals to remit overseas freely up to USD 2,50,000.
 3. Subsidiary General Ledger maintained by Public Debt Office of RBI.
 4. Current accounts denominated in foreign currency, maintained by banks with their correspondent banks.

- (A) P-3, Q-4, R-1, S-2
 (B) P-4, Q-3, R-2, S-1
 (C) P-1, Q-2, R-3, S-4
 (D) P-2, Q-1, R-4, S-3

May/June 2014

36. Read the following scenario and answer the question that follows:

Delta Manufacturing, a corporate entity with a net worth of Rs. 150 crores, requires short-term funding and decides to issue Commercial Paper (CP) for a maturity of 180 days instead of availing a traditional working capital loan linked to the MCLR.

What is the primary reason the CFO of Delta Manufacturing prefers to issue Commercial Paper instead of availing a traditional working capital loan?

- (A) CPs do not require any repayment of principal upon maturity due to their revolving nature.
 (B) Issuing CPs enhances the company's equity capital base and improves its overall leverage ratio.
 (C) CPs automatically convert into equity shares after the 180-day maturity period has been completed.
 (D) Market rates on CPs are generally lower than MCLR-related interest rates charged

exactly 91 days, 182 days, and 364 days.

- (D) Their announcement is made by the Reserve Bank of India through a Press Release issued one day prior to the auction.

Oct/Nov 2012

63. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options given below:
Assertion (A): Interest rate arbitrage through a currency swap is always possible between two freely convertible currencies.
Reason (R): Between free currencies, the forward premium or discount is perfectly equal to the interest rate differentials, eliminating arbitrage opportunities.
(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2015

64. Several entities are permitted to participate in the call money market. Which of the following is currently NOT eligible to participate?
(A) Scheduled Commercial Banks
(B) Payment Banks
(C) Primary Dealers
(D) Mutual Funds

Oct/Nov 2008

65. The following question consists of two statements: an Assertion (A) and a Reason (R). Select the correct answer using the options given below:
Assertion (A): Banks are generally cautious and prefer not to invest heavily as leading investors in domestic stock markets.
Reason (R): Stock prices are highly volatile, and banks are bound by strict prudential ceilings prescribed by RBI on capital market exposures.
(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2023

66. Indian companies and banks engage in various interactions within domestic and global markets. Which of the following is NOT an approved mechanism for this interaction?
(A) Raising External Commercial Borrowings up to USD 750 mn for eligible sectors without prior RBI approval.
(B) Holding export earnings in an EEFC account.
(C) Issuing ADRs/GDRs where the exchange risk is borne by the issuing Indian company.
(D) Investing in joint ventures overseas via Overseas Direct Investment up to 4 times their net worth.

Oct/Nov 2019

67. Read the following scenario and answer the question that follows:
Alpha Bank holds a surplus of USD funds. However, the treasury manager identifies a lucrative domestic investment opportunity in a 3-month Rupee-denominated Commercial Paper (CP). The treasury manager decides to use the swap route rather than borrowing Rupees directly from the call money market. The bank sells USD at the spot rate to generate Rupee funds and simultaneously buys back the USD 3 months forward. The interest earned on the CP turns out to be higher than the effective cost of the USD funds.
What type of swap transaction did Alpha Bank execute to fund its investment in the Commercial Paper?
(A) USD/INR Funding Swap
(B) Forward to Forward Swap
(C) Interest Rate Swap
(D) Non-Deliverable Forward Swap

May/June 2011

68. What is the most accurate description of how the Reserve Bank of India utilises Repo under the Liquidity Adjustment Facility (LAF)?
(A) As a tool to permanently acquire foreign currency reserves from commercial banks to manage the exchange rate.
(B) As a mechanism to absorb excess liquidity by selling government securities with a fixed commitment to repurchase them.

foreign governments.

Oct/Nov 2022

43. Consider the following statements regarding spot and forward trades:

- I. TOD and TOM rates are always identical to the SPOT rate regardless of interest rate differentials.
- II. Forward exchange rates are arrived at on the basis of interest rate differentials of two currencies, added or deducted from the spot exchange rate.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2005

44. How is the 'Yield to Maturity' of an investment defined?

- (A) The difference between sale and repurchase prices adjusted for income earned on securities during the contract period.
- (B) The interest rate differential of two currencies added to or subtracted from the prevailing spot exchange rate.
- (C) The internal rate of return assuming interest is reinvested at the same rate, expressed as a compounded annual percentage.
- (D) The margin maintained with the clearing house or exchange by various participants operating in the futures market.

Oct/Nov 2011

45. Consider the following statements regarding Certificates of Deposit (CD):

- I. CDs can be issued by banks in physical promissory note form as well as in demat form.
- II. Banks cannot sanction any loan against CDs or permit premature closure of CDs.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2024

46. In the call money market, when are funds borrowed by banks required to be repaid?
- (A) On the same day before the close of business

hours.

- (B) On the next working day.
- (C) Between 2 days and 14 days.
- (D) On the 14th day from the date of borrowing.

Oct/Nov 2018

47. Consider the following statements regarding Corporate Debt Paper:

- I. It refers to medium and long-term bonds and debentures issued by corporates and financial institutions.
- II. They are eligible for meeting the SLR requirement of banks.
- III. Tier-2 capital bonds issued by banks fall under this category.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2013

48. What is the minimum bid size under the Standing Deposit Facility (SDF)?

- (A) Rupees one lakh and in multiples thereof.
- (B) Rupees five lakhs and in multiples thereof.
- (C) Rupees one crore and in multiples thereof.
- (D) Rupees five crores and in multiples thereof.

Oct/Nov 2009

49. Consider the following statements regarding Government Securities:

- I. They are issued by the Public Debt Office of the Reserve Bank of India on behalf of the Government of India.
- II. The price of the bonds is determined in an auction conducted by RBI, while the interest is paid on the face value at the coupon rate.
- III. The yield on bonds and the price of the bonds move in the same direction.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2021

50. How are forward exchange rates conceptually determined in perfect markets with fully convertible currencies?

- (A) They are projected exchange rate movements based primarily on forecasted inflation

reset periodically.

2. Discounted securities issued at a price much lower than the face value.
 3. Bonds which are not secured by mortgages, but secured by stocks or other collateral.
 4. Bonds sold at a discounted value where interest is paid only on maturity and not during the lock-in period.
- (A) P-2, Q-1, R-4, S-3
(B) P-1, Q-4, R-2, S-3
(C) P-4, Q-2, R-3, S-1
(D) P-3, Q-1, R-4, S-2

Oct/Nov 2005

75. Read the following scenario and answer the question that follows:

A foreign investor wishes to speculate on INR movements without physical delivery and decides to use an offshore derivative contract settled in cash due to regulatory restrictions in the onshore market.

Which instrument is the foreign investor most likely using to speculate on the INR in the offshore market without physical delivery?

- (A) Non-Deliverable Forward (NDF)
(B) Exchange Earners' Foreign Currency Account
(C) External Commercial Borrowing
(D) Global Depository Receipt

May/June 2020

76. Match the entities/agencies in List I with their respective full names in List II:

List I: (Entities/Agencies)

- P. CRISIL
Q. CARE
R. IVRPL
S. SIDBI

List II: (Full Names)

1. Credit Analysis & Research Limited
 2. Infomerics Valuation and Rating Private Limited
 3. Small Industries Development Bank of India
 4. The Credit Rating Information Services of India Limited
- (A) P-4, Q-1, R-2, S-3
(B) P-1, Q-4, R-3, S-2
(C) P-3, Q-2, R-1, S-4
(D) P-2, Q-3, R-4, S-1

Oct/Nov 2016

77. Read the following scenario and answer the question that follows:

Delta Manufacturing has a net worth of Rs. 150 crores and an 'A3' credit rating from CRISIL. It issues Commercial Paper (CP) for 180 days in demat form with a bank acting as the Issuing and Paying Agent (IPA).

Is Delta Manufacturing eligible to issue Commercial Paper according to the regulatory guidelines?

- (A) No, because CPs can only be issued for a maximum maturity of 90 days.
(B) Yes, because it has an 'A3' credit rating and its net worth exceeds Rs. 100 crores.
(C) No, because CPs must be issued in physical promissory note form, not demat form.
(D) Yes, but only if the RBI provides a sovereign guarantee for the issue.

May/June 2014

78. Match the types of bank investments in List I with their accounting categories in List II:

List I: (Types of Bank Investments)

- P. Held to Maturity (HTM)
Q. Available for Sale (AFS)
R. Held for Trading (HFT)
S. Cash Balances

List II: (Accounting Categories)

1. Consist of tradable securities actively traded and marked-to-market regularly.
 2. Form part of eligible SLR at the branch level.
 3. Consist of securities mainly for investment purpose and placed under the Banking Book.
 4. Consist of tradable securities that must be marked to market at least quarterly.
- (A) P-3, Q-4, R-1, S-2
(B) P-1, Q-2, R-3, S-4
(C) P-4, Q-1, R-2, S-3
(D) P-2, Q-3, R-4, S-1

Oct/Nov 2007

79. Read the following scenario and answer the question that follows:

Omega Bank invests primarily in 10-year Government Securities (G-Secs) to fulfill its Statutory Liquidity Ratio (SLR) requirement. A portion of these G-Secs is kept purely for investment purposes, while another portion is actively traded.

- (C) As an instrument to infuse liquidity by lending to banks against the sale of government securities to the RBI.
- (D) As a facility exclusively available for funding long-term infrastructure projects in the public and private sectors.

Oct/Nov 2025

69. Read the following scenario and answer the question that follows:

Alpha Bank executes a USD/INR swap to fund a 3-month Rupee-denominated Commercial Paper (CP) investment, finding that the interest earned on the CP exceeds the effective cost of the USD funds.

Why is there a possibility of earning a profit from interest rate arbitrage in this specific USD/INR swap?

- (A) Because Commercial Papers are completely risk-free instruments backed by sovereign guarantees from the government.
- (B) Because the USD and INR are both fully convertible currencies operating in perfect and efficient global markets.
- (C) Because the RBI mandates a fixed forward premium for all 3-month USD/INR swaps to ensure market stability.
- (D) Because the Rupee's partial convertibility allows supply and demand to influence forward rates alongside interest differentials.

May/June 2016

70. What is the most accurate description of how the Reserve Bank of India utilises Repo under the Liquidity Adjustment Facility (LAF)?

- (A) As a tool to permanently acquire foreign currency reserves from commercial banks to manage the exchange rate.
- (B) As a mechanism to absorb excess liquidity by selling government securities with a fixed commitment to repurchase them.
- (C) As an instrument to infuse liquidity by lending to banks against the sale of government securities to the RBI.
- (D) As a facility exclusively available for funding long-term infrastructure projects in the public and private sectors.

Oct/Nov 2013

71. Read the following scenario and answer the question that follows:

Beta Bank parks surplus funds of Rs. 10 Crores

with the RBI under the Standing Deposit Facility (SDF).

How will the Rs. 10 Crores deposited by Beta Bank under the SDF be treated for regulatory reserve calculations?

- (A) It will be reckoned as an eligible balance for the maintenance of CRR only.
- (B) It will be reckoned as an eligible asset for the maintenance of SLR but not for CRR.
- (C) It will be exempted from both CRR and SLR maintenance.
- (D) It will be treated as Tier-2 capital under the Banking Regulation Act.

May/June 2009

72. Arrange the following inter-bank money market segments in increasing order of their maturity periods:

- I. Term money
- II. Notice money
- III. Call money

- (A) III, I, II
- (B) III, II, I
- (C) II, III, I
- (D) I, II, III

Oct/Nov 2021

73. Read the following scenario and answer the question that follows:

Gamma Imports Ltd., an Indian company, expects a payment in EUR after three months. Fearing the depreciation of the Rupee against the EUR, the company enters into a forward contract with its bank to cover the currency risk.

What mechanism is Gamma Imports Ltd. using to protect itself against the adverse movement of the EUR/INR exchange rate?

- (A) Forward Contract (Merchant Business)
- (B) Interest Rate Swap
- (C) Non-Deliverable Forward
- (D) Foreign Exchange Spot Trade

May/June 2006

74. Match the bond types in List I with their characteristics in List II:

List I: (Bond Types)

- P. Zero coupon bonds
- Q. Floating rate bonds
- R. Deep discount bonds
- S. Collateralised obligations

List II: (Characteristics)

- 1. Coupon is linked to a benchmark which is

ANSWERS

1. (B) Because yields on corporate bonds and debentures are higher than the yield on government securities.
Corporate debentures usually carry higher credit risk than government securities. To compensate for this risk, they offer higher yields. Banks include them in their investment portfolios to enhance overall returns. While government securities are safer for liquidity and statutory requirements, corporate bonds provide a spread over risk-free rates, improving the treasury's profitability and diversifying income sources.
2. (C) Standing Deposit Facility (SDF) – Minimum bid size is Rupees one lakh.
The Standing Deposit Facility is a liquidity absorption tool used by the central bank. Unlike some other instruments, the minimum bid size for the Standing Deposit Facility is set at Rupees one crore, with further bids in multiples thereof. This high threshold ensures participation from institutional players while effectively managing system-wide excess liquidity without the need for collateral.
3. (A) Marking to Market
Marking to market is the process of valuing financial assets or liabilities based on current market rates. This practice ensures that the financial statements reflect the real-time economic value of the portfolio. It is essential for transparency and risk management, as it captures unrealized gains or losses resulting from market fluctuations, providing a realistic view of an entity's financial health.
4. (C) Both I and II
Commercial Paper is an unsecured money market instrument issued in the form of a promissory note. To ensure credit quality, the issuing company must maintain a minimum credit rating of A3 from approved agencies. Additionally, regulatory guidelines mandate that the issue should be for a minimum amount of Rupees five lakhs and in multiples of five lakhs thereafter for investors.
5. (D) A foreign currency account where exporters are allowed to hold up to 100% of export proceeds without earning interest.
The Exchange Earners' Foreign Currency account is a facility provided to foreign exchange earners, including exporters. It allows them to credit up to one hundred percent of their foreign exchange earnings into a foreign currency account maintained in India. These accounts do not earn interest but help account holders manage currency conversion costs and mitigate exchange rate risks for future transactions.
6. (B) Only II
The Standing Deposit Facility allows banks to park surplus funds with the central bank without collateral. While these deposits are not considered for the maintenance of the Cash Reserve Ratio, they are explicitly recognized as eligible assets for meeting the Statutory Liquidity Ratio requirements. This dual role helps banks manage their liquidity positions while simultaneously adhering to mandatory regulatory investment norms.
7. (C) Two working days from the trade date.
In the foreign exchange market, a spot trade involves the purchase or sale of a foreign currency with a standard settlement period. The actual exchange of funds and delivery of the currency typically take place on the second working day following the date of the transaction. This two-day window allows for administrative processing and coordination across different international time zones.
8. (B) I and III only.
Rediscounting of foreign bills is an inter-bank financing mechanism where a treasury refinances bills negotiated by another bank. This is considered a funded credit product rather than a pure treasury product because the bank retains recourse. Due to the usance period and associated risks, the pricing for such bill rediscounting is generally higher compared to standard overnight money market placements.

43. (B) Only II

Forward exchange rates are fundamentally derived from the interest rate parity theory. They are calculated by adding a premium or subtracting a discount from the current spot rate, based on the interest rate differentials between the two currencies involved. TOD and TOM rates are not always identical to the spot rate, as they also reflect the cost of carry for those specific short-term settlement periods.

44. (C) The internal rate of return assuming interest is reinvested at the same rate, expressed as a compounded annual percentage.

Yield to maturity is a comprehensive measure of a bond's expected return. It represents the internal rate of return that equates the present value of all future cash flows, including interest payments and principal repayment, to the current market price. This calculation assumes that all periodic coupon payments are reinvested at the same rate until the instrument matures, providing a standardized annual return.

45. (B) Only II

Certificates of deposit are negotiable money market instruments. While they were historically issued in physical form, they are now issued only in dematerialized form as per regulatory mandates. To maintain the stability of bank deposits and ensure the instrument's integrity, banks are prohibited from granting loans against these certificates or allowing investors to close them before their scheduled maturity date.

46. (B) On the next working day.

Call money is a highly liquid segment of the money market used primarily by banks to manage their daily cash reserve requirements. In a call money transaction, funds are borrowed on an overnight basis. This means that the principal amount, along with the agreed interest, must be repaid by the borrower to the lender on the next working day following the transaction.

47. (C) I and III only

Corporate debt paper includes medium and long-term instruments like bonds and debentures issued by private companies and financial institutions. This category also encompasses Tier-2 capital bonds issued by banks. Importantly, unlike government securities, corporate debt

paper is not eligible for meeting the Statutory Liquidity Ratio requirements that banks must fulfill. These instruments are primarily held for investment and income generation.

48. (C) Rupees one crore and in multiples thereof.

The Standing Deposit Facility is a tool used by the central bank to absorb excess liquidity from the banking system. To participate in this facility, banks must submit bids that meet a specific threshold. The minimum amount for any single bid under this facility is set at Rupees one crore, and any additional amount must be in multiples of one crore.

49. (A) I and II only

Government securities are issued by the central bank on behalf of the government through an auction process. While the interest is paid as a fixed coupon on the face value, the price is determined by market demand. Crucially, bond prices and yields move in opposite directions; as yields go up, bond prices go down, and as yields decrease, bond prices increase.

50. (C) They are based on interest rate differentials of two currencies added to or deducted from the spot rate.

In an ideal market with fully convertible currencies, forward rates are determined by the theory of interest rate parity. The forward price is the spot rate adjusted for the difference in interest rates between the two currencies for the duration of the contract. This adjustment, known as the forward premium or discount, ensures that there are no risk-free arbitrage opportunities.

51. (B) I and III only

The Liberalised Remittance Scheme allows resident individuals to remit up to two hundred fifty thousand US dollars per financial year for various permitted purposes. However, the funds cannot be used for prohibited activities such as gambling or margin trading. Furthermore, banks are strictly prohibited from providing any form of credit or loan to customers specifically for making remittances under this scheme.

instruments and are primarily governed by the law of contracts. While both serve as means of raising long-term capital, their regulatory requirements and methods of transferability differ based on their legal classification.

18. (A) I, II, III, and IV only

Market repo involves borrowing funds against collateral, with the principal amount usually being less than the market value of the securities due to a haircut. Funds borrowed against government securities are exempt from reserve requirements, whereas corporate bond repos are not. While various entities participate, market participants are generally not permitted to borrow against the collateral of their own securities.

19. (A) The Non-Competitive Bidding Scheme for Treasury Bills is extended to CMBs.

Cash Management Bills are flexible, short-term instruments issued by the government to manage temporary cash flow mismatches. They are issued at a discount and are eligible for statutory liquidity ratio requirements. Unlike standard Treasury bills, the non-competitive bidding scheme is not extended to these instruments. Their maturities are specifically designed to be shorter than ninety-one days to address immediate liquidity needs.

20. (B) I, II, III, and V only

Treasury bills are issued in electronic form through auctions at a discount to face value. Different tenors, including ninety-one day and one hundred eighty-two day bills, are issued on specific days of the week or fortnight. While individuals can participate through non-competitive bidding, the cap for such participation is set at five percent of the notified amount, not ten percent.

21. (D) Banks' capital market exposures are capped at not exceeding 50% of the paid-up share capital of the investee company.

Preference shares carry preferential rights for dividends and capital return upon liquidation. Current corporate laws prohibit the issuance of irredeemable preference shares. Regarding regulatory limits, a bank's capital market exposure is strictly controlled to manage risk. Specifically, a bank's investment in the equity of any single company is capped at thirty percent

of that company's paid-up share capital or thirty percent of the bank's own paid-up share capital and reserves.

22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Forward exchange rates are not predictions of future spot rates but are calculated based on interest rate parity. They are determined by taking the current spot rate and adjusting it for the interest rate differential between the two currencies involved. Consequently, the forward rate is a mechanical reflection of current cost-of-carry rather than a forecast of future market direction or currency strength.

23. (B) Secured or unsecured

Preference share capital is categorized based on various rights and features. Common classifications include cumulative or non-cumulative regarding dividends, participating or non-participating in surplus profits, and redeemable or irredeemable regarding capital repayment. However, the distinction of being secured or unsecured is generally applicable to debt instruments like debentures and bonds, rather than to preference share capital.

24. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

There is an inverse relationship between bond prices and market interest rates. When market rates rise above a bond's fixed coupon rate, the bond becomes less attractive to investors. To provide a competitive yield that matches the new market environment, the bond's market price must decrease. This price adjustment ensures that the total return from the bond aligns with prevailing rates.

25. (A) Real estate properties

Options and futures contracts derive their value from underlying assets. Common assets for these derivatives include physical commodities like gold and wheat, individual equity stocks, and broad stock market indices. While real estate is a significant asset class, it is not standard for exchange-traded options contracts due to its illiquidity and the lack of standardized, high-

9. (B) 2%

The Marginal Standing Facility serves as a window for banks to borrow overnight funds from the central bank during emergency liquidity shortfalls. Following the withdrawal of temporary pandemic-related relaxations, eligible entities can avail of these funds up to two percent of their respective Net Demand and Time Liabilities. This facility carries a higher interest rate than the standard repo rate.

10. (A) I and II only

External Commercial Borrowings allow Indian companies to access global capital markets for funding projects. Eligible borrowers can raise up to seven hundred fifty million dollars per financial year under the automatic route. However, the exchange rate risk is entirely borne by the domestic borrower, not the overseas lender. These borrowings must comply with specified minimum average maturity and all-in-cost ceilings.

11. (A) The bank purchases securities using surplus cash, earning interest on secured lending while holding securities eligible for SLR compliance.

A reverse repo transaction is a mechanism where a bank lends surplus cash to the central bank or other participants against government securities. Conceptually, the bank buys these securities with a commitment to sell them back. This allows the bank to earn interest on a secured basis while the securities held can be used for meeting statutory liquidity requirements.

12. (A) I, II, and III only

Regulatory authorities prescribe prudential limits for borrowing in various money market segments to ensure systemic stability. Scheduled commercial banks are limited to borrowing one hundred percent of their capital funds in call and notice money. Primary dealers and cooperative banks also face specific limits based on their net owned funds or deposits. However, payment banks and regional rural banks follow similar prudential frameworks.

13. (B) Via an automatic sweep where the correspondent bank invests excess funds overnight in the money market.

Nostro accounts are foreign currency accounts maintained by domestic banks with

correspondent banks abroad. Since these are generally current accounts that do not pay interest, banks use automated sweep-in facilities. This mechanism allows the correspondent bank to invest unutilized balances overnight in the local money market on behalf of the domestic bank, thereby generating interest income on otherwise idle funds.

14. (A) I, II, and III only

Tripartite Repo Trades involve a third-party agent, the Clearing Corporation of India, which manages collateral selection and settlement. This entity provides a novation facility, acting as a central counterparty to mitigate risk. While participants must be members of the clearing corporation, initial margins are not restricted to securities alone; cash is also permitted as a form of collateral.

15. (D) Their price is determined through an auction process where banks and primary dealers are the main participants.

Treasury bills are short-term debt instruments issued by the central government to manage fiscal requirements. They do not pay periodic interest but are issued at a discount to their face value. The final price is determined through a competitive auction process involving institutional participants like banks and primary dealers. The difference between the purchase price and face value represents the return.

16. (B) II, III, and IV only

Interaction between domestic and global markets occurs through various channels. Holders of Global Depositary Receipts can sell their holdings in domestic markets, and banks are permitted to invest foreign currency deposit funds in overseas markets. Additionally, exporters can access finance in foreign currency. However, foreign institutional investors primarily focus on portfolio investments in stocks and bonds rather than direct long-term projects.

17. (B) Debentures are governed by Company Law and require registration, while bonds are negotiable instruments under contract law.

In the domestic financial market, debentures are debt instruments governed by the Companies Act and typically require formal registration. In contrast, bonds are often treated as negotiable

risk. To neutralize this risk, the treasury typically enters into an offsetting transaction in the inter-bank market. By taking a reverse position of equal value and maturity, the bank ensures that any gain or loss is balanced.

35. (A) P-3, Q-4, R-1, S-2

A Subsidiary General Ledger account is used for maintaining government securities. Nostro accounts are foreign currency accounts held by banks with overseas correspondents. Exchange Earners' Foreign Currency accounts allow exporters to hold foreign currency proceeds. Finally, the Liberalised Remittance Scheme permits individuals to remit funds abroad. Matching these terms correctly aligns the specific financial products with their operational descriptions and regulatory purposes.

36. (D) Market rates on CPs are generally lower than MCLR-related interest rates charged by commercial banks.

Large corporate entities often prefer issuing commercial paper over taking traditional bank loans because it can be more cost-effective. Market interest rates for short-term debt like commercial paper are typically lower than the Marginal Cost of Funds-based Lending Rate set by banks. By tapping the money market directly, highly rated companies can reduce their interest expenses and diversify their funding sources.

37. (A) P-3, Q-2, R-1, S-4

Financial Benchmarks India Limited publishes key interest rate benchmarks like MIBOR. The Clearing Corporation of India manages the TREPS platform and acts as a tri-party agent. The Securities and Exchange Board of India regulates the stock market and investor protection. The Fixed Income Money Market and Derivatives Association prescribes standard market practices for instruments such as commercial paper and bonds.

38. (C) The CP should not be bought back before a minimum period of 30 days from its issue. Regulatory guidelines allow issuers of commercial paper to buy back the instrument before maturity. However, to ensure that the instrument serves its purpose as a short-term debt obligation and to maintain market discipline, a minimum holding period is mandated. Specifically, an issuer cannot

buy back the commercial paper until at least thirty days have passed since the original date of issue.

39. (B) Short Call – The seller has the obligation to sell the underlying asset if the buyer exercises the option.

In an options contract, the seller of a call option, also known as the writer, takes on an obligation. If the buyer chooses to exercise their right to purchase the underlying asset at the strike price, the seller must deliver that asset. This is distinct from the buyer, who holds the right but not the obligation to execute the trade during the contract.

40. (A) The price of the bonds will fall.

There is an inverse mathematical relationship between bond yields and bond prices. When market yields increase, existing bonds with lower coupon rates become less attractive compared to new issues. Consequently, the market value of these existing bonds must decrease to provide a yield that is competitive with the current market. This price drop results in mark-to-market losses for actively traded portfolios.

41. (A) Commercial Paper – Minimum 30 days and maximum 1 year

Money market instruments are classified by their duration. Call money is for overnight use, while notice money lasts between two and fourteen days. Term money covers periods from fifteen days up to one year. However, commercial paper has a minimum maturity of seven days, not thirty days, though its maximum maturity remains capped at one year as per current regulatory guidelines.

42. (B) A combination of spot and forward transactions, or a combination of two forward transactions.

A foreign exchange swap is a dual-leg transaction where two parties exchange currencies and agree to reverse the exchange at a later date. It typically involves a spot transaction combined with an offsetting forward transaction, or it can involve two separate forward transactions with different maturity dates. These swaps are used to manage liquidity and hedge exchange rate risks without changing net positions.

approved agency. Since the entity in the scenario meets both the net worth threshold and the rating requirement, it is eligible to access the money market through commercial paper.

78. (A) P-3, Q-4, R-1, S-2

Banks classify their investment portfolios into categories for accounting and valuation. Held to Maturity securities are kept for long-term investment. Available for Sale securities are tradable but must be marked to market at least quarterly. Held for Trading securities are actively traded and valued daily. Cash balances at the branch level are also part of the regulatory assets used for meeting statutory liquidity requirements.

79. (D) Held to Maturity (HTM)

When a bank intends to hold a security until its final maturity date rather than trading it for short-term gains, it classifies the investment as Held to Maturity. These securities are part of the bank's long-term investment book and are not subject to frequent mark-to-market valuations. This category is typically used for government securities that the bank holds to meet its long-term statutory requirements.

80. (D) They have a right to participate in surplus funds after equity capital is paid during winding up.

Preference shares are a unique form of capital that combines features of both debt and equity. While they have priority in dividend payments, some types, known as participating preference shares, also grant holders the right to share in any surplus profits or assets remaining after equity shareholders have been paid during the company's liquidation process. This provides an additional potential benefit beyond the fixed dividend rate.

NODIA

- 52.** (D) They allow hedging for currencies that are not fully convertible without requiring physical delivery of the domestic currency. Non-deliverable forward markets exist to facilitate the trading of currencies that have restricted convertibility. Since the domestic currency cannot be easily traded offshore, these contracts are settled in a major convertible currency like the US dollar. Only the difference between the agreed rate and the actual market rate is exchanged, allowing participants to manage risk without violating domestic currency controls.
- 53.** (B) II, III, and IV only
Futures contracts are standardized agreements traded on organized exchanges rather than over the counter. Participants must maintain initial and variation margins to ensure financial integrity. Most futures positions are closed out before maturity through offsetting trades, resulting in very few physical deliveries. Because the exchange acts as a central counterparty for every trade, the risk of individual counterparty default is eliminated.
- 54.** (C) It is an easily liquifiable market that remains open 24 by 7, offering the largest trading volume in the world.
The foreign exchange market is the largest and most liquid financial market globally. It operates as an over-the-counter market without a single physical location, allowing for continuous twenty-four-hour trading across global time zones. High liquidity is characterized by narrow buy-sell spreads. Unlike the spot market, which usually settles in two days, this market provides constant opportunities for currency exchange and hedging.
- 55.** (B) II, III, and IV only
Banks face regulatory restrictions on their involvement in the stock market to ensure stability. Their exposure to any single company's equity is capped at thirty percent of that company's share capital. Additionally, total direct investment is limited to twenty percent of the bank's net worth. Indirect exposures, such as providing guarantees to stockbrokers, are also included in the calculation of capital market limits.
- 56.** (A) Every issue and renewal of a CP is treated as a fresh issue.
Commercial paper is a short-term, unsecured debt instrument. According to regulatory requirements, each new issuance and even the renewal of an existing commercial paper must be formally treated as a fresh issue. This ensures that the issuer continues to meet credit rating and documentation standards. Banks are generally required to hold these instruments in dematerialized form rather than physical promissory notes.
- 57.** (B) I, III, IV, and V only
Cash Management Bills are flexible instruments used by the government to manage short-term liquidity needs. They are issued at a discount with maturities specifically shorter than ninety-one days. These bills are eligible for the Statutory Liquidity Ratio and can be used in repo transactions. Settlement for these auctions occurs on a T+1 basis, providing a quick mechanism for government cash flow management.
- 58.** (B) A Call option gives the holder the obligation to buy the specified quantity of the underlying asset at the strike price.
An option contract provides the buyer with a choice rather than a mandate. A call option gives the holder the right, but not the obligation, to purchase an asset. If the buyer chooses not to exercise this right, they simply lose the premium paid. In contrast, the seller of the option does have a binding obligation if the buyer decides to exercise.
- 59.** (B) I, II, IV, and V only
In the domestic market, debentures are formal debt instruments that require registration for transfer. They can be structured with various features, including convertibility into equity shares or embedded put and call options. Private placements are regulated to limit the number of investors per tranche. Deep discount bonds differ because they typically do not pay periodic interest, instead providing a single payout at maturity.
- 60.** (C) Banks can sanction loans against CDs and permit premature closure of CDs.
Certificates of deposit are issued by banks and financial institutions to raise short-term funds.

Financial institutions can issue them for tenors between one and three years. These instruments must be held in dematerialized form and require reserve maintenance. To ensure the stability of the funding, regulations strictly forbid banks from lending against these certificates or allowing depositors to withdraw funds prematurely.

61. (A) I, II, III, and V only

Various bond structures exist to meet different investor needs. Zero-coupon bonds are sold at a discount, while floating-rate bonds have coupons that adjust with market benchmarks. Bonds with put or call options often use step-up coupons to manage redemption incentives. Collateralized obligations are secured by assets, but these assets are not limited to real estate and can include various other financial securities.

62. (C) They are issued for standard maturities of exactly 91 days, 182 days, and 364 days.

Cash Management Bills are distinct from regular Treasury bills because they are specifically designed for very short-term government financing needs. While regular Treasury bills have standardized maturities of ninety-one, one hundred eighty-two, and three hundred sixty-four days, Cash Management Bills are issued for flexible, non-standard periods that are always less than ninety-one days, helping manage temporary cash flow gaps.

63. (D) Assertion (A) is false, but Reason (R) is true. In theory, between two perfectly free and convertible currencies, the forward premium or discount should exactly match the interest rate differential. This alignment follows the interest rate parity principle, which effectively removes the possibility of risk-free arbitrage. Therefore, in a perfect market, a currency swap cannot be used to gain an extra profit beyond what is justified by interest rate levels.

64. (D) Mutual Funds

The call money market is an inter-bank market used for very short-term lending and borrowing. While commercial banks, cooperative banks, and primary dealers are eligible to participate, other entities have been restricted. Mutual funds, which were previously allowed to lend in this market, were phased out by the regulator to focus

the call market on managing the liquidity of the banking system.

65. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Banks generally limit their investments in the equity market because stock prices are highly volatile and can lead to significant capital erosion. To protect the financial system, the central bank mandates strict prudential limits on how much a bank can invest in capital markets. These regulations ensure that banks maintain a conservative risk profile, prioritizing the safety of depositor funds over higher-risk equity returns.

66. (C) Issuing ADRs/GDRs where the exchange risk is borne by the issuing Indian company.

Indian companies can interact with global markets through several approved routes, such as external commercial borrowings, overseas direct investments, and maintaining EEFC accounts. When a company issues American or Global Depository Receipts, the exchange rate risk is typically borne by the international investors who hold the receipts, rather than the issuing Indian company, which receives the capital in the specified currency.

67. (A) USD/INR Funding Swap

A funding swap occurs when a bank uses one currency to fund an investment in another currency. By selling US dollars at the spot rate to obtain Indian Rupees and simultaneously buying the dollars back in the forward market, the bank secures the necessary funds for its domestic investment while fixing the future exchange rate. This structure allows the bank to manage its liquidity across different currencies.

68. (C) As an instrument to infuse liquidity by lending to banks against the sale of government securities to the RBI.

The Reserve Bank uses the repo rate as a primary tool for monetary policy to control the money supply. When the banking system faces a liquidity shortage, the central bank infuses funds by allowing banks to sell their government securities to the RBI with a promise to buy them back. This provides banks with immediate cash to meet their operational and regulatory requirements.

- 69.** (D) Because the Rupee's partial convertibility allows supply and demand to influence forward rates alongside interest differentials. In markets with fully convertible currencies, interest rate parity usually prevents arbitrage. However, because the Indian Rupee is only partially convertible, its forward rates are influenced by local supply and demand factors in addition to interest rate differentials. This market imperfection creates opportunities for banks to earn a profit when the yield on a domestic investment exceeds the combined cost of funding and the swap.
- 70.** (C) As an instrument to infuse liquidity by lending to banks against the sale of government securities to the RBI. A repo transaction under the Liquidity Adjustment Facility is a short-term mechanism for the central bank to provide liquidity to the banking sector. Banks provide government securities as collateral in exchange for cash. This process is essential for managing daily fluctuations in the money market and ensuring that the banking system has sufficient funds to operate smoothly while meeting their reserve obligations.
- 71.** (B) It will be reckoned as an eligible asset for the maintenance of SLR but not for CRR. The Standing Deposit Facility is a liquidity management tool that allows banks to park excess funds with the central bank. According to regulatory guidelines, the balances maintained under this facility are treated as eligible assets for fulfilling the Statutory Liquidity Ratio. However, these deposits do not count toward the Cash Reserve Ratio, which must be maintained as separate cash balances.
- 72.** (B) III, II, I
The inter-bank money market is categorized by the duration of the funds lent. Call money represents the shortest duration, as it involves overnight lending. Notice money covers a slightly longer period, ranging from two to fourteen days. Term money refers to funds lent for any period exceeding fourteen days and up to one year. Thus, the increasing order of maturity is call, notice, and term money.
- 73.** (A) Forward Contract (Merchant Business)
When a corporate entity like an importer or exporter enters into an agreement with a bank to buy or sell foreign currency at a fixed rate for a future date, it is known as a merchant forward contract. This mechanism allows the business to lock in the exchange rate today, effectively hedging against the risk of future adverse currency movements and providing certainty for their financial planning.
- 74.** (A) P-2, Q-1, R-4, S-3
Zero-coupon bonds are issued at a discount to face value. Floating-rate bonds have variable interest payments linked to a market benchmark. Deep discount bonds are sold at a low price and pay the full interest only upon maturity. Collateralized obligations are debt instruments secured by assets like stocks or other securities, providing an additional layer of protection for the lender beyond a simple promise to pay.
- 75.** (A) Non-Deliverable Forward (NDF)
A Non-Deliverable Forward is a derivative instrument used in offshore markets to speculate on or hedge currencies that are not fully convertible. Since physical delivery of the restricted currency is not possible outside its home country, these contracts are settled in a convertible currency like the US dollar. The settlement amount is based on the difference between the contracted rate and the prevailing market spot rate.
- 76.** (A) P-4, Q-1, R-2, S-3
CRISIL is a prominent credit rating agency in India, as is CARE. IVRPL refers to Infomercials Valuation and Rating Private Limited. SIDBI is a specialized financial institution focused on the development of small industries. Accurately matching these abbreviations with their full names is essential for understanding the various participants and regulatory bodies that operate within the Indian financial and credit markets.
- 77.** (B) Yes, because it has an 'A3' credit rating and its net worth exceeds Rs. 100 crores. Companies wishing to issue commercial paper must meet specific regulatory criteria regarding their financial health and creditworthiness. This includes having a minimum net worth and obtaining a credit rating of at least A3 from an

frequency valuation required for derivative trading.

- 26.** (D) Assertion (A) is false, but Reason (R) is true. Historically, non-bank entities like mutual funds and insurance companies were allowed to participate in the call money market. However, to ensure better monetary control, these participants were gradually phased out. Since August 2005, the call money market in India has been restricted exclusively to scheduled commercial banks, primary dealers, and cooperative banks, making it a purely inter-bank liquidity market.
- 27.** (A) To hedge currency risks and speculate on restricted currencies that face regulatory barriers in onshore markets.
Non-deliverable forwards are used primarily for currencies that are not fully convertible or face significant regulatory restrictions in their home markets. These contracts allow market participants to hedge exposure or speculate on exchange rate movements without the need for physical currency delivery. Settlement occurs in a freely convertible currency, like the US dollar, based on the rate difference.
- 28.** (C) It consists of the interest at the market rate plus the forward premium for the 3-month period.
When a bank uses a swap to fund an investment in a different currency, the effective cost of funds is determined by the combination of interest rates and the swap cost. In this scenario, the total cost for the US dollar funds includes the prevailing market interest rate plus the forward premium paid to buy back the dollars at the end of the period.
- 29.** (B) It acts as a tri-party agent providing novation facility, collateral selection, and settlement services while collecting initial margins.
The Clearing Corporation of India plays a vital role in Tripartite Repo Trades by acting as a central counterparty. It provides a novation facility, which effectively eliminates individual counterparty risk. Additionally, the corporation manages the selection of collateral and oversees the entire settlement process. To protect against market volatility, it also collects initial margins from participants in either cash or securities.

- 30.** (C) 5.15%
The Standing Deposit Facility rate is linked to the policy repo rate as part of the liquidity management framework. It is typically set at twenty-five basis points below the repo rate. If the policy repo rate is five point four percent, the rate for the Standing Deposit Facility would be five point one five percent. This facility allows banks to earn a floor rate on surplus funds.
- 31.** (D) Because of high volatility and regulatory ceilings prescribed by the RBI on capital market exposures.
Bank treasuries approach equity investments with caution due to the inherent price volatility of the stock market. Furthermore, central bank regulations impose strict prudential limits on a bank's total exposure to the capital market. These ceilings are designed to prevent banks from taking excessive risks that could jeopardize depositor safety and overall financial stability, leading to a preference for debt instruments.
- 32.** (D) A Repo transaction where it sells government securities to the RBI with a commitment to repurchase them.
The Liquidity Adjustment Facility allows banks to manage daily liquidity mismatches by borrowing from the central bank. This is structured as a repo transaction. The bank sells its government securities to the central bank to raise immediate funds while simultaneously agreeing to repurchase those same securities at a predetermined price and future date, effectively paying interest for the short-term liquidity.
- 33.** (A) II, III, I
Foreign exchange transactions have different settlement timelines based on the trade date. TOD, also known as cash, refers to settlement on the same day as the trade. TOM refers to settlement on the next working day. SPOT refers to the standard settlement on the second working day following the trade. Therefore, the chronological order from earliest to latest is TOD, TOM, and then SPOT.
- 34.** (C) By taking a reverse/opposite position in the inter-bank market.
When a bank treasury enters into a forward contract with a corporate client, it creates an open position that exposes the bank to exchange rate

CHAPTER 21

International Equity and Debt Products

May/June 2005

1. Pioneer Tech, a listed Indian company, receives a foreign investment amounting to 11% of its post issue paid-up equity capital on a fully diluted basis. Later, to finance capital goods imports, it raises a Trade Credit (TC) in USD for a 3-year tenor. Subsequently, a dilution of shares drops the foreign investment to 9%. Based on the foreign exchange regulations, what is the status of the foreign investment and the TC?
(A) Investment reclassified as FPI; TC maturity is compliant.
(B) Investment remains FDI; TC maturity is compliant.
(C) Investment remains FDI; TC maturity violates the 1-year cap.
(D) Investment reclassified as FPI; TC must be converted to INR.

Oct/Nov 2012

2. Consider the following statements for ECBs raised for working capital, general corporate purposes, or repayment of Rupee loans:
 - I. The ECB can be raised from foreign branches / subsidiaries of Indian banks.
 - II. The prescribed MAMP will have to be strictly complied with under all circumstances.Which of the statements is/are correct?
(A) Only I is correct
(B) Only II is correct
(C) Both I and II are correct
(D) Neither I nor II is correct

May/June 2018

3. What does the term 'Fully diluted basis' signify in the context of foreign investment?
(A) The total outstanding shares assuming all potential conversion sources are fully exercised.
(B) The specific proportion of equity shares held by Foreign Portfolio Investors post-issue.
(C) The total paid-up equity capital excluding preference shares and all convertible debentures.

- (D) The net outstanding shares after deducting those held specifically by the Indian Custodian.

Oct/Nov 2024

4. What is the All-in-cost ceiling per annum for new External Commercial Borrowings (ECBs) in Foreign Currency?
(A) Benchmark rate plus 450 basis points
(B) Benchmark rate plus 550 basis points
(C) Benchmark rate plus 350 basis points
(D) Benchmark rate plus 500 basis points

May/June 2021

5. Identify the correct statement regarding an existing foreign investment in a listed Indian company.
(A) If an existing investment falls below 10%, it is immediately reclassified as an FPI.
(B) If an existing investment falls below 10% on a fully diluted basis, it remains FDI.
(C) An investment in an unlisted Indian company must exceed 10% to be classified as FDI.
(D) Existing investments falling below 10% must be repatriated to comply with FEMA rules.

Oct/Nov 2006

6. Consider the following activities regarding the use of External Commercial Borrowing (ECB) proceeds:
 - I. Real estate activities
 - II. Investment in capital market
 - III. Equity investment
 - IV. Working capital purposes (unless specific exceptions apply)
 - V. Repayment of Rupee loans (unless specific exceptions apply)Which of the above are included in the negative list for which ECB proceeds cannot be utilised?
(A) I, II, and III only
(B) II, III, IV, and V only
(C) I, IV, and V only

NODIA

the Indian domestic market. A SEBI registered Stock Broker now wishes to purchase these shares to convert them back into GDRs. Which of the following reflects the correct regulatory position?

- (A) It is prohibited as GDRs once redeemed cannot be reissued under any circumstances.
- (B) Fresh approval from the Ministry of Finance is required for every reissuance transaction.
- (C) It is permitted under limited two-way fungibility within original issue levels.
- (D) It is permitted only if the shares are converted into ADRs complying with US GAAP.

May/June 2012

- 61.** How are Trade Credits (TC) defined in the context of international debt products?
- (A) Commercial loans from non-residents to residents for general corporate purposes.
 - (B) Credits from overseas for import of goods under the Foreign Trade Policy.
 - (C) Negotiable receipts issued abroad representing equity shares of an Indian entity.
 - (D) Rupee denominated bonds issued overseas to finance specific housing projects.

Oct/Nov 2014

- 62.** What is the overall cap for raising of capital by issuance of IDRs by eligible foreign companies in Indian markets?
- (A) USD 1.5 billion
 - (B) USD 750 million
 - (C) USD 5 billion
 - (D) USD 50 million

May/June 2019

- 63.** Consider the following statements regarding Trade Credits (TC):
- I. Suppliers' credit is arranged by the supplier of goods located outside India.
 - II. Buyers' credit is arranged by banks, financial institutions, and foreign equity holders located outside India.
 - III. Foreign branches/subsidiaries of Indian banks are permitted as recognised lenders for INR TC only.
 - IV. Participation of Indian banks operating from IFSCs as lenders is subject to RBI prudential guidelines.
- Which combination is correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

Oct/Nov 2006

- 64.** Arrange the following rules/events regarding IDRs in the correct chronological order based on their regulatory timeline:
- 1. Issuance of IDRs by a foreign company through a Domestic Depository.
 - 2. Minimum lock-in period before IDRs can be redeemed into underlying shares.
 - 3. Holding of underlying shares by resident individuals for the purpose of sale.
- (A) 3, 2, 1
 - (B) 1, 2, 3
 - (C) 3, 1, 2
 - (D) 2, 3, 1

May/June 2021

- 65.** Consider the All-in-cost ceilings for Trade Credits:
- I. For existing FCY TCs linked to LIBOR changed to ARR, the ceiling is Benchmark Rate plus 350 bps spread.
 - II. For new FCY TCs, the ceiling is Benchmark rate plus 300 bps spread.
 - III. For INR TCs, the ceiling is Benchmark rate plus 250 bps spread.
- Which of the statements is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2010

- 66.** Identify the correct statement regarding the application of FEMA provisions to the holding of underlying shares on redemption of IDRs.
- (A) FEMA provisions strictly apply to the holding of underlying shares by FPIs.
 - (B) FEMA provisions require immediate repatriation of shares by Indian Mutual Funds.
 - (C) FEMA provisions do not apply to the holding of underlying shares by FPIs.
 - (D) FEMA provisions prohibit Listed Indian companies from holding shares post-conversion.

lottery business. Which of the following applies to this transaction?

- (A) It is permitted under the automatic route provided it stays within the specified limit.
- (B) It is prohibited as technology collaboration in the lottery business is not allowed.
- (C) It is permitted subject to obtaining prior approval from the relevant sectoral regulator.
- (D) It is permitted only if the Indian company is unlisted and funds are non-repatriable.

Oct/Nov 2009

14. Zeta Infra Ltd. raises an FCY ECB with an average maturity of 4 years. According to the board-approved risk management policy, what is the mandatory hedging requirement for this exposure?
- (A) 100 per cent of the ECB exposure
 - (B) 50 per cent of the ECB exposure
 - (C) 70 per cent of the ECB exposure
 - (D) Mandatory hedging is not required for infrastructure companies

May/June 2023

15. When an Indian company issues Global Depository Receipts (GDRs), how is the company's Debt Equity Ratio (DER) and the exchange risk managed?
- (A) The DER is adversely affected, and the issuing company bears the exchange risk.
 - (B) The DER increases proportionally, and the Indian Custodian hedges the exchange risk.
 - (C) The DER is not adversely affected, and the Depository bears the exchange risk.
 - (D) The DER is not adversely affected, and the investor bears the exchange risk.

Oct/Nov 2018

16. Under the automatic route, what is the standard maximum limit for eligible borrowers to raise ECB per financial year?
- (A) USD 50 million
 - (B) USD 150 million
 - (C) USD 1.5 billion
 - (D) USD 750 million

May/June 2007

17. Consider the following statements regarding Global Depository Receipts (GDRs):
- I. The underlying shares are held by an Indian Custodian on behalf of the Overseas Depository.

- II. Dividend is paid out in foreign currency directly to the overseas investors.
- III. The Depository is entitled to voting rights as it holds the equity shares on behalf of the GDR holders.

Which of the statements is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2025

18. Identify the incorrect statement regarding the issuance of guarantees for ECBs.
- (A) Issuance of any type of guarantee by Indian banks relating to ECB is not permitted.
 - (B) Non-Banking Financial Companies (NBFCs) are prohibited from issuing ECB guarantees.
 - (C) All India Financial Institutions may issue guarantees under the automatic route.
 - (D) Financial intermediaries shall not invest in FCCBs/FCEBs in any manner whatsoever.

May/June 2012

19. Match the following items in List I with their descriptions in List II while preserving correctness:

List I: Entities/Concepts

- P. Overseas Investor
- Q. Depository
- R. Indian Custodian
- S. Stock Broker

List II: Roles/Features

- 1. Holds underlying shares on behalf of the Overseas Depository
 - 2. Bears the exchange risk on the GDR
 - 3. Purchases shares from the market for conversion into ADRs/GDRs
 - 4. Entitled to voting rights for holding equity shares
- (A) P-2, Q-4, R-1, S-3
 - (B) P-1, Q-2, R-3, S-4
 - (C) P-4, Q-3, R-2, S-1
 - (D) P-2, Q-1, R-4, S-3

Oct/Nov 2014

20. Theta Pvt Ltd plans to raise a FCY ECB of USD 4 million from its direct foreign equity holder. The company currently has no other outstanding ECBs. Does the company need to adhere to the 7:1 ECB liability-equity ratio for this transaction?

Oct/Nov 2017

46. For how long shall any Foreign Institutional Investor (FII) holding a valid certificate of registration be deemed to be an FPI from the enactment of the SEBI (FPI) Regulations, 2014?
- (A) Till the expiry of the block of one year
 - (B) Till the expiry of the block of five years
 - (C) Till the expiry of the block of three years
 - (D) Till the expiry of the block of ten years

May/June 2008

47. ECB proceeds CANNOT be utilised for working capital purposes EXCEPT when raised from which of the following sources?
- (A) Multilateral Financial Institutions providing long-term development funding to India.
 - (B) Foreign branches of Indian banks operating in various international financial hubs.
 - (C) Individual investors subscribing to bonds issued in compliant overseas jurisdictions.
 - (D) Foreign equity holder (subject to an MAMP of 5 years).

Oct/Nov 2013

48. Investment by a person resident outside India is prohibited in all of the following sectors, EXCEPT:
- (A) Lottery Business including government or private lotteries and online lottery systems.
 - (B) Trading in Transferable Development Rights (TDRs) for real estate and construction.
 - (C) Manufacturing of Cigars, cheroots, cigarillos, and tobacco substitutes for export purposes.
 - (D) Chit funds for investments made by NRIs or OCIs on a non-repatriation basis.

May/June 2015

49. Omega Corp defaults on its ECB covenants. The lender imposes a penal interest of 3.5 percent over and above the contracted rate of interest on the outstanding principal. Is this penal interest permissible under the ECB framework?
- (A) Yes, because penal interest is excluded from the all-in-cost ceiling limits.
 - (B) No, penal interest should not exceed 2% over the contracted rate.
 - (C) Yes, provided the borrower maintains a minimum investment-grade credit rating.
 - (D) No, penal interest is strictly prohibited under the current ECB framework.

Oct/Nov 2012

50. Identify the incorrect pair regarding foreign investment prohibitions:
- (A) Atomic energy — Prohibited for private sector investment
 - (B) Chit funds — Prohibited except for NRIs/OCIs on non-repatriation basis
 - (C) Lottery Business — Prohibited but foreign technology collaboration is permitted
 - (D) Real Estate Business — Prohibited

May/June 2011

51. Under the ECB hedging provisions, which of the following accurately describes a 'Natural Hedge'?
- (A) Offsetting cash flows in matching currency, net of all projected outflows.
 - (B) Indexing domestic revenues to foreign currency to offset the ECB liability.
 - (C) Using derivative products with AD Category I banks to hedge the exposure.
 - (D) Rolling over a financial hedge periodically to ensure exposure is not unhedged.

Oct/Nov 2020

52. Alpha Inc., a foreign entity, initially invested in 12 percent of the post issue paid-up equity capital on a fully diluted basis of Beta Ltd., a listed Indian company. Due to a recent dilution of shares, Alpha Inc.'s holding drops to 8.5 percent. How will this investment be classified post-dilution?
- (A) It will be reclassified as Foreign Portfolio Investment (FPI).
 - (B) It must be liquidated within 30 days due to a breach of the minimum threshold.
 - (C) It will be classified as a Trade Credit until the 10 percent threshold is restored.
 - (D) It will continue to be treated as Foreign Direct Investment (FDI).

May/June 2022

53. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.
- Assertion (A): Change of currency from INR ECB to any freely convertible foreign currency is not permitted.
- Reason (R): Overseas investors in INR ECB are eligible to hedge their exposure in Rupee through permitted derivative products in India.

V. The sale by resident individuals must occur within 30 days from the date of conversion. Which combination of statements is correct?

- (A) I, II, III, and V
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2022

26. Regarding the change of currency of Trade Credits (TC), which of the following conversions is NOT permitted?

- (A) FCY TC into INR TC
- (B) One freely convertible foreign currency to another freely convertible foreign currency
- (C) INR TC to any freely convertible foreign currency
- (D) Change of currency of FCY TC at the exchange rate prevailing on the date of agreement

May/June 2018

27. Mr. Sharma, a resident individual in India, converts his IDRs into the underlying equity shares of the issuing foreign company. Under the foreign exchange regulations, what is the maximum duration he is permitted to hold these underlying shares?

- (A) 30 days from the date of conversion
- (B) 1 year from the date of issue
- (C) Indefinitely, subject to sectoral caps
- (D) 6 months from the date of redemption

Oct/Nov 2016

28. Marine Crafters, a shipbuilder in India, wishes to raise a Trade Credit for the import of non-capital goods. According to the TC framework, what is the maximum period allowed for this specific Trade Credit reckoned from the date of shipment?

- (A) Up to one year or operating cycle, whichever is less
- (B) Up to five years
- (C) Up to three years
- (D) Up to ten years

May/June 2014

29. Which of the following accurately describes the structure of External Commercial Borrowings (ECBs)?

- (A) Commercial loans from residents to non-residents in Indian Rupee-only transactions.

(B) Commercial loans from non-residents to residents in foreign currency or INR.

(C) Equity instruments issued to foreign portfolio investors with a fixed maturity period.

(D) Short-term trade credits from overseas suppliers exclusively for capital goods imports.

Oct/Nov 2007

30. Identify the correct statement regarding Rupee Denominated Bonds (RDBs) issued overseas.

- (A) RDBs can be issued to finance any general corporate purpose without restrictions.
- (B) Not more than 75% of the 'eligible amount' can be issued in foreign currency.
- (C) RDBs can be issued for PDI qualifying as Additional Tier 1 capital.
- (D) RDBs issued are strictly included within the FPI limit for corporate bonds.

May/June 2025

31. Identify the incorrect statement regarding the Incorrect Borrowers for External Commercial Borrowings.

- (A) All entities eligible to receive FDI are eligible to raise FCY ECB.
- (B) Port Trusts and Units in SEZ are eligible to raise FCY ECB.
- (C) All entities eligible to raise FCY ECB are also eligible to raise INR ECB.
- (D) Registered entities engaged in micro-finance activities are eligible to raise FCY ECB.

Oct/Nov 2019

32. Consider the rules for issuing Rupee Denominated Bonds (RDBs) overseas:

- I. They can be issued to finance infrastructure and affordable housing.
- II. Debt capital instruments qualifying for Tier 2 capital under Basel III can be issued.
- III. More than 50% of the 'eligible amount' can be issued in foreign currency/RDB overseas.
- IV. RDBs issued must be excluded from the limit for investments by FPIs in corporate bonds.

Which combination is correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

May/June 2009

33. Consider the following statements regarding Recognised Lenders for ECBs:

- I. The lender must be a resident of a FATF or IOSCO compliant country.
- II. Individuals as lenders are permitted only if they are foreign equity holders or for subscription to bonds/debentures listed abroad.
- III. Foreign branches/subsidiaries of Indian banks are permitted as recognised lenders for both FCY and INR ECBs.

Which of the statements is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2011

34. Match the following items in List I with their descriptions in List II while preserving correctness:

List I: Keywords

- P. Buyers Credit
- Q. Fully Diluted Basis
- R. External Commercial Borrowing
- S. Suppliers Credit

List II: Definitions

1. Trade Credit arranged by supplier of goods located outside India.
2. Commercial loans raised by eligible resident entities from recognised non-resident entities.
3. Total number of shares that would be outstanding if all possible sources of conversion are exercised.
4. Trade Credit arranged by Banks, Financial Institutions located outside India.

- (A) P-4, Q-3, R-2, S-1
- (B) P-1, Q-2, R-3, S-4
- (C) P-4, Q-1, R-2, S-3
- (D) P-3, Q-4, R-1, S-2

May/June 2010

35. Foreign branches/subsidiaries of Indian banks can participate as arrangers, underwriters, market-makers, or traders for Rupee denominated Bonds issued overseas, EXCEPT when:

- (A) The issuances are made by Indian banks.
- (B) The borrower is an Indian manufacturing company.

- (C) The bonds are placed privately in FATF compliant countries.
- (D) The average maturity of the bonds exceeds 5 years.

Oct/Nov 2024

36. Consider the following regarding the regulations for External Commercial Borrowings (ECBs):

- I. ECBs up to USD 750 million per year come under the Automatic Route.
- II. Domestic Banks are prohibited from guaranteeing repayment of ECBs.
- III. ECB raised in Indian Rupee can be freely converted into foreign currency.

Which of the statements is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2017

37. The London branch of an Indian bank wishes to underwrite Rupee denominated Bonds issued overseas by its parent Indian bank. Is this transaction permissible under the ECB framework?

- (A) Yes, because foreign branches of Indian banks are recognised lenders for INR ECBs.
- (B) Yes, provided the maturity of the bonds exceeds a minimum period of 3 years.
- (C) No, because Indian banks cannot issue Rupee denominated Bonds in overseas markets.
- (D) No, underwriting by foreign branches for parent bank issuances is not allowed.

Oct/Nov 2005

38. Consider the following regulatory constraints:

- I. Issuance of GDR does not adversely affect the Debt Equity Ratio.
- II. SEBI monitors the USD 5 billion cap for IDRs.
- III. Change of currency from one freely convertible currency to another is freely permitted for ECB.
- IV. The maximum maturity of TC for import of capital goods is one year.

Which combination is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

May/June 2020

39. Which of the following correctly pairs the ECB end-use with its prescribed Minimum Average Maturity Period (MAMP)?
- (A) Repayment of Rupee loans for purposes other than capital expenditure — 7 years.
 - (B) Working capital purposes (not from foreign equity holder) — 10 years.
 - (C) General corporate purposes raised from a foreign equity holder — 3 years.
 - (D) ECB raised by manufacturing companies for amounts up to USD 50 million — 5 years.

Oct/Nov 2015

40. An Indian bank plans to issue Perpetual Debt Instruments (PDIs) overseas. Its Risk Weighted Assets (RWAs) are INR 100,000 crores and its Total Additional Tier 1 capital is INR 1,200 crores as of March 31. What is the 'eligible amount' for issuing PDIs in foreign currency?
- (A) INR 1,500 crores
 - (B) INR 1,200 crores
 - (C) INR 2,700 crores
 - (D) INR 100,000 crores

May/June 2013

41. Arrange the following ECB purposes in ascending order of their prescribed Minimum Average Maturity Period (MAMP):
1. General corporate purposes from a foreign equity holder.
 2. Repayment of Rupee loans availed domestically for capital expenditure.
 3. Repayment of Rupee loans availed domestically for purposes other than capital expenditure.
 4. ECB raised by manufacturing companies up to USD 50 million.
- (A) 4, 1, 2, 3
 - (B) 1, 4, 2, 3
 - (C) 4, 2, 1, 3
 - (D) 4, 1, 3, 2

Oct/Nov 2021

42. Foreign Direct Investment (FDI) is defined as investment through capital instruments by a person resident outside India in:
- (A) 10 percent or more of the post-issue paid-up equity capital of a specific unlisted Indian company.
 - (B) An unlisted Indian company or 10% or more of a listed company on a fully diluted basis.

- (C) Less than 10 percent of the post-issue paid-up equity capital of a specific listed Indian company.
- (D) Any capital instrument on a non-repatriable basis irrespective of the sector or percentage.

May/June 2024

43. Delta Manufacturing Pvt. Ltd. plans to raise an ECB of USD 40 million equivalent to expand its factory operations in the current financial year. What is the Minimum Average Maturity Period (MAMP) required for this borrowing under the specified category?
- (A) 1 year
 - (B) 3 years
 - (C) 5 years
 - (D) 7 years

Oct/Nov 2008

44. Which of the following scenarios best represents a Foreign Portfolio Investment (FPI)?
- (A) Investment of 15% or more in the post-issue paid-up equity capital of a listed Indian company.
 - (B) Investment by a person resident outside India in an unlisted Indian company's capital instruments.
 - (C) Investment of less than 10% in a listed Indian company on a fully diluted basis.
 - (D) Existing investment in a listed Indian company falling below the 10% threshold during a sale.

May/June 2006

45. Consider the following statements regarding the 'Other Costs' and All-in-cost ceilings of ECBs:
- I. The enhanced all-in-cost ceiling temporarily increased by 100 bps is available universally to all borrowers.
 - II. Prepayment charges/penal interest should not be more than 2 percent over and above the contracted rate of interest.
 - III. Penal interest for default is calculated on the outstanding principal amount.
 - IV. Prepayment charges are included within the all-in-cost ceiling limits.
- Which combination of statements is correct?
- (A) I and II
 - (B) II and III
 - (C) III and IV
 - (D) I and IV

- (A) Yes, the 7:1 ratio is mandatory for all ECBs from foreign equity holders.
- (B) Yes, because the borrower is an unlisted private company in the Indian market.
- (C) No, the ratio applies strictly to Indian Rupee (INR) denominated ECBs.
- (D) No, the ratio is not applicable for amounts up to USD 5 million.

May/June 2019

21. Consider the following statements regarding Indian Depository Receipts (IDRs):

- I. IDRs shall be denominated in freely convertible foreign currency.
- II. The proceeds of the issue of IDRs shall be immediately repatriated outside India.
- III. Issue of IDRs by financial companies having presence in India requires prior approval of the sectoral regulator.
- IV. IDRs cannot be redeemed into underlying equity shares before the expiry of one year from the date of issue.

Which combination is correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, and IV

Oct/Nov 2006

22. Match the following items in List I with their descriptions in List II while preserving correctness:

List I: Trade Credit (TC) Parameter

- P. Amount under automatic route for oil/gas refining companies
- Q. Period of TC for import of capital goods
- R. Period of TC for import of non-capital goods
- S. Amount under automatic route for other companies

List II: Detail

- 1. Up to USD 50 million per import transaction
- 2. Up to USD 150 million per import transaction
- 3. Up to three years
- 4. Up to one year or operating cycle whichever is less

- (A) P-2, Q-3, R-4, S-1
- (B) P-1, Q-3, R-4, S-2
- (C) P-2, Q-4, R-3, S-1
- (D) P-3, Q-2, R-1, S-4

May/June 2021

23. Which of the following pairs correctly matches the investor type with the source of funds permitted for investing in IDRs?

- (A) Foreign Portfolio Investor (FPI) — Funds held in EEFC account
- (B) Non-Resident Indian (NRI) — Funds held in NRE / FCNR(B) account
- (C) Resident Individual — Funds held in FCNR(B) account
- (D) Overseas Corporate Body (OCB) — Funds held in SNRR account

Oct/Nov 2010

24. Consider the following statements concerning the period of Trade Credits (reckoned from the date of shipment):

- I. The period of TC for import of capital goods shall be up to three years.
- II. The period of TC for import of non-capital goods is up to one year or the operating cycle, whichever is less.
- III. For shipyards/shipbuilders, the period of TC for import of non-capital goods can be up to three years.
- IV. The period limits are identical for both FCY denominated TC and INR denominated TC.
- V. Operating cycles longer than three years permit a proportional extension of the TC period for non-capital goods.

Which of the above statements are correct according to the Foreign Exchange Management (FEMA) regulations?

- (A) I, II, III, and IV
- (B) I, II, and III only
- (C) II, III, IV, and V
- (D) I, III, IV, and V

May/June 2005

25. Consider the following regarding the limited two-way fungibility of Indian Depository Receipts (IDRs):

- I. Listed Indian companies may sell or continue to hold underlying shares.
- II. Indian Mutual Funds registered with SEBI may sell or continue to hold underlying shares.
- III. Resident individuals can hold underlying shares indefinitely.
- IV. Resident individuals are allowed to hold underlying shares only for the purpose of sale.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2023

54. Which of the following accurately defines Global Depository Receipts (GDRs)?
- (A) Receipts that entitle the holder to convert into equity shares of a foreign company.
 - (B) Non-negotiable debt instruments issued by an Indian Company for foreign markets.
 - (C) Negotiable receipts issued abroad representing equity shares of an Indian Company.
 - (D) Receipts issued by an Indian Depository representing equity shares traded in the US.

May/June 2016

55. Sigma Corp. has revenues indexed to the US Dollar and claims this arrangement as a 'natural hedge' against its USD denominated ECB. Does this comply with the ECB hedging guidelines?
- (A) Yes, indexed revenues are universally accepted as a valid natural hedge.
 - (B) No, indexed revenues are not considered a valid natural hedge.
 - (C) Yes, provided the offsetting exposure occurs within the same accounting year.
 - (D) No, natural hedge is only permitted for INR denominated ECB transactions.

Oct/Nov 2009

56. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.
- Assertion (A): On issuance of GDR, the Debt Equity Ratio of the issuing company is not adversely affected.
- Reason (R): The equity of the issuing company increases upon the issuance of GDRs.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2023

57. Consider the following statements regarding the limit and leverage under the ECB framework:
- I. For FCY denominated ECB raised from a direct foreign equity holder, the ECB liability-equity ratio under the automatic route cannot exceed 7:1.
 - II. This 7:1 ratio limit is strictly applicable even if the outstanding amount of all ECB is less than USD 5 million.
- Which of the statements is/are correct?
- (A) Only I is correct
 - (B) Only II is correct
 - (C) Both I and II are correct
 - (D) Neither I nor II is correct

Oct/Nov 2018

58. Identify the incorrect statement regarding Depository Receipts.
- (A) ADRs are traded only in the US while GDRs are traded in other overseas markets too.
 - (B) Soliciting investors for ADRs can be done globally without specific accounting standards compliance.
 - (C) Reissuance of ADR/GDR is permitted to the extent of ADRs/GDRs redeemed into underlying shares and sold in the domestic market.
 - (D) The total outstanding shares under the GDR issuance remains at the same level of the original issue under the limited two-way fungibility scheme.

May/June 2007

59. Which of the following describes the temporary relaxation regarding the automatic route limit for ECBs available till December 31, 2022?
- (A) The limit was increased from USD 750 million to USD 1.5 billion.
 - (B) The limit was removed entirely for all infrastructure sector companies.
 - (C) The limit was increased from USD 50 million to USD 150 million.
 - (D) The liability-equity ratio was relaxed to a maximum level of 10:1.

Oct/Nov 2025

60. An Indian firm issued GDRs which were later redeemed into underlying shares and sold in

(D) I, II, III, IV, and V

May/June 2013

7. Consider the following statements regarding Foreign Investment:

- I. It is any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of an LLP.
- II. Investment by a person resident outside India is strictly prohibited in Chit funds without any exception.

Which of the statements is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

Oct/Nov 2019

8. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.

Assertion (A): Change of currency of FCY ECB into INR ECB is freely permitted.

Reason (R): The exchange rate for such change can be the rate prevailing on the date of the agreement or a lesser rate, if consented to by the ECB lender.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2025

9. Which of the following activities is NOT explicitly prohibited for foreign investment according to the Foreign Exchange Management (FEMA) regulations?

- (A) Wholesale cash and carry operations relating to tobacco products
- (B) Construction of Farm Houses
- (C) Foreign technology collaboration for Gambling and Betting activities
- (D) Nidhi company operations

Oct/Nov 2014

10. Consider the following operational aspects with respect to mandatory hedging for ECBs:

- I. The ECB borrower is required to cover only the principal amount through financial hedges.
- II. A minimum tenor of one year for the financial hedge is required with periodic rollover.
- III. The financial hedge must start from the day the liability is created in the books of the borrower.

Which of the statements is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2008

11. A citizen of Pakistan intends to invest in an Indian entity. Which of the following represents the most accurate regulatory stance?

- (A) Prior Government approval is required, with restrictions on defence and space sectors.
- (B) The investment is strictly prohibited under all circumstances without any regulatory exception.
- (C) The investment can be made under the automatic route for amounts up to USD 50 million.
- (D) The investment is permitted only in unlisted Indian companies on a non-repatriation basis.

Oct/Nov 2020

12. Identify the correct statement regarding the recognition of a natural hedge for ECB exposures.

- (A) Any arrangement where revenues are indexed to foreign currency is a valid hedge.
- (B) Natural hedge can fully replace financial hedge regardless of matching currency.
- (C) Offsetting exposure must occur within the same accounting year.
- (D) Natural hedge is applicable only to Indian Rupee denominated ECB transactions.

May/June 2016

13. Gamma Corp., a foreign entity, wishes to license its trademark and franchise management systems to an Indian company engaged in the

May/June 2013

67. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.

Assertion (A): Overseas investors of INR denominated Trade Credits are eligible to hedge their exposure in Rupee.

Reason (R): They can access the domestic market through branches/subsidiaries of Indian banks abroad on a back-to-back basis.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2019

68. An NRI wishes to invest in Indian Depository Receipts (IDRs) issued by a foreign company. The NRI plans to use funds from an NRO account. Is this transaction compliant with the regulations?

- (A) Yes, NRIs can invest in IDRs using any Rupee-denominated account in India.
 (B) Yes, provided the total investment does not exceed a limit of USD 5 million.
 (C) No, NRIs are strictly prohibited from investing in IDRs under FEMA regulations.
 (D) No, NRIs may invest in IDRs only out of NRE or FCNR(B) accounts.

May/June 2025

69. Global Oil Refining Ltd., based in India, executes a single import transaction for crude oil. They intend to use the automatic route to raise Trade Credit. What is the maximum equivalent amount they can raise for this transaction under the automatic route?

- (A) USD 50 million
 (B) USD 750 million
 (C) USD 5 billion
 (D) USD 150 million

Oct/Nov 2011

70. Consider the following instruments:

- I. Floating/fixed rate notes/bonds/debentures
 II. Fully and compulsorily convertible instruments

III. Trade credits beyond 3 years

IV. Financial Lease

V. Plain vanilla Rupee denominated bonds issued overseas

Which of these are permitted under the External Commercial Borrowings (ECB) framework?

- (A) I, II, III, and IV
 (B) I, III, IV, and V
 (C) II, III, IV, and V
 (D) I, II, IV, and V

May/June 2010

71. Consider the following concerning the 'eligible amount' for the issue of Perpetual Debt Instruments (PDIs) in foreign currency:

- I. It is determined as on March 31 of the previous financial year.
 II. It is the higher of 1.5% of Risk Weighted Assets (RWAs) and Total Additional Tier 1 capital.

Which of the statements is/are correct?

- (A) Only I is correct
 (B) Only II is correct
 (C) Both I and II are correct
 (D) Neither I nor II is correct

Oct/Nov 2024

72. Match the following items in List I with their descriptions in List II while preserving correctness:

List I: ECB Parameters

- P. Currency
 Q. Instrument Type includes
 R. Eligible Borrower includes
 S. Recognised Lenders

List II: Details for Indian Rupee (INR) ECB

1. Foreign branches/subsidiaries of Indian banks (subject to applicable prudential norms)
 2. Indian Rupee
 3. Registered Not for Profit companies
 4. Plain vanilla Rupee denominated bonds issued overseas
 (A) P-2, Q-4, R-3, S-1
 (B) P-4, Q-2, R-1, S-3
 (C) P-2, Q-3, R-4, S-1
 (D) P-3, Q-1, R-2, S-4

May/June 2017

73. The following question consists of two statements — Assertion (A) and Reason (R).

of these capacities for issuances made specifically by Indian banks. This restriction prevents the circular movement of funds and maintains the independence of the domestic banking sector's capital.

36. (A) I and II only

Eligible borrowers can raise External Commercial Borrowings up to seven hundred and fifty million US dollars annually under the automatic route. Domestic banks are strictly prohibited from guaranteeing the repayment of these loans to protect the Indian financial system. While foreign currency ECBs can be converted to Rupees, the reverse conversion of Rupee-denominated ECBs into foreign currency is prohibited.

37. (D) No, underwriting by foreign branches for parent bank issuances is not allowed.

Under the regulatory framework for Rupee Denominated Bonds issued overseas, foreign branches or subsidiaries of Indian banks are not permitted to act as underwriters, arrangers, or market-makers for issuances by Indian banks. This policy ensures that the capital raised from international markets is genuinely sourced from external investors rather than from the internal networks or foreign arms.

38. (A) I, II, and III

The issuance of Global Depository Receipts increases the equity base and does not negatively impact the debt-to-equity ratio. The Securities and Exchange Board of India monitors the five billion dollar cap for Indian Depository Receipts. Additionally, borrowers are allowed to change the currency of their External Commercial Borrowing between different freely convertible foreign currencies to manage exchange risk.

39. (B) Working capital purposes (not from foreign equity holder) — 10 years.

External Commercial Borrowings used for working capital purposes, when not raised from a foreign equity holder, are required to have a minimum average maturity period of ten years. This long-term requirement ensures that such debt is not used for short-term financing needs. Other categories, such as manufacturing sector loans up to fifty million dollars, have a shorter one-year maturity.

40. (A) INR 1,500 crores

For an Indian bank issuing Perpetual Debt Instruments overseas, the 'eligible amount' is calculated as the higher of one point five percent of its total Risk Weighted Assets or its Total Additional Tier 1 capital. Given RWAs of one hundred thousand crores, one point five percent equals fifteen hundred crores, which exceeds the twelve hundred crore Additional Tier 1 capital.

41. (A) 4, 1, 2, 3

The minimum average maturity period for External Commercial Borrowings varies by purpose. Manufacturing companies raising up to fifty million dollars have the shortest requirement at one year. Borrowings for general corporate purposes from foreign equity holders require five years. Repaying Rupee loans for capital expenditure requires seven years, while repayment for other purposes has the longest requirement.

42. (B) An unlisted Indian company or 10% or more of a listed company on a fully diluted basis.

Foreign Direct Investment is defined as an investment by a person resident outside India in the capital instruments of an unlisted Indian company. For listed Indian companies, it is defined as a holding of ten percent or more of the post-issue paid-up equity capital on a fully diluted basis. This classification distinguishes long-term strategic investments from shorter-term portfolio-based investments.

43. (A) 1 year

Manufacturing companies raising External Commercial Borrowings up to fifty million US dollars or its equivalent per financial year are allowed a shorter minimum average maturity period. Under this specific category, the required maturity is only one year. This provision allows manufacturing entities to access international debt markets for relatively smaller amounts with greater flexibility to support their operational and expansion needs.

44. (C) Investment of less than 10% in a listed Indian company on a fully diluted basis.

Foreign Portfolio Investment is defined as an investment made by a person resident outside India in the capital instruments of a listed Indian company where the holding is less than ten

hold or sell IDRs.

- (B) The proceeds of the issue of IDRs must be immediately repatriated outside India.
- (C) Foreign branches of Indian banks can act as recognised lenders only for FCY TC.
- (D) Dividends for GDRs are paid out in foreign currency to the Depository.

Oct/Nov 2008

- 80.** Identify the incorrect pair regarding the specific categories for MAMP exceptions:
- (A) Working capital purposes from foreign equity holder — MAMP 5 years
 - (B) Repayment of Rupee loans for capital expenditure — MAMP 7 years
 - (C) Repayment of Rupee loans for purposes other than capital expenditure — MAMP 10 years
 - (D) Manufacturing companies up to USD 50 million — MAMP 5 years

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Answer the question by selecting the appropriate option.

Assertion (A): Rupee Denominated Bonds (RDBs) issued overseas have to be excluded from the limit for investments by FPIs in corporate bonds.

Reason (R): RDBs are instruments representing equity shares of an Indian entity traded in overseas markets.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2005

74. What is the policy regarding foreign branches/subsidiaries of Indian banks participating in External Commercial Borrowings?
- (A) Prohibited from participating in any capacity in both FCY and INR ECB transactions.
 - (B) Permitted as lenders for FCY ECB and as arrangers for Rupee Bonds overseas.
 - (C) Permitted as recognised lenders for both FCY and INR ECBs without any restrictions.
 - (D) Permitted to act as underwriters for Rupee denominated Bonds issued by Indian banks.

May/June 2020

75. Consider the following points regarding international equity and debt products:
- I. Lottery and Real Estate come under the negative list for Investments from overseas.
 - II. GDRs represent tradable receipts in foreign currency which can be converted into equity shares.
 - III. IDRs represent Rupee denominated receipts issued by a foreign company to Indian residents.
 - IV. The exchange risk in FCY ECB is borne by the borrower.
 - V. Trade credits up to equivalent of USD 50 million come under the automatic approval route for most sectors.

Which of the above statements is/are correct?

- (A) I, II, III, and V
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2015

76. A registered society engaged in micro-finance activities in India plans to raise External Commercial Borrowings to fund its operations. Under which category and currency is the society permitted to raise the ECB?
- (A) FCY ECB only
 - (B) Both FCY and INR ECB
 - (C) INR ECB only
 - (D) Neither FCY nor INR ECB

May/June 2013

77. Which of the following best describes the maximum tenor and all-in-cost capping for non-capital imports under Trade Credits?
- (A) 3 years tenor and benchmark plus 350 basis points.
 - (B) 12 months tenor and benchmark plus 250 basis points.
 - (C) 12 months tenor and benchmark plus 450 basis points.
 - (D) 3 years tenor and benchmark plus 250 basis points.

Oct/Nov 2021

78. Match the following items in List I with their descriptions in List II while preserving correctness:

List I: ECB purpose/category

- P. Manufacturing companies up to USD 50 million
- Q. General corporate purposes from foreign equity holder
- R. On-lending by NBFCs for working capital purposes
- S. Repayment of Rupee loans availed domestically for capital expenditure

List II: Minimum Average Maturity Period (MAMP)

- 1. 5 years
- 2. 7 years
- 3. 10 years
- 4. 1 year
- (A) P-4, Q-1, R-3, S-2
- (B) P-1, Q-4, R-2, S-3
- (C) P-4, Q-2, R-1, S-3
- (D) P-3, Q-1, R-4, S-2

May/June 2024

79. Identify the incorrect statement regarding international funding options.
- (A) An FPI or an NRI or an OCI may purchase,

9. (A) Wholesale cash and carry operations relating to tobacco products

Foreign investment is strictly prohibited in sectors such as the construction of farm houses, Nidhi companies, and lottery businesses. However, wholesale cash and carry operations, including those relating to tobacco products, are permitted. While manufacturing tobacco products is restricted, the trade-related activity of wholesale cash and carry does not fall under the list of prohibited sectors for foreign investors.

10. (B) II and III only

Mandatory hedging for External Commercial Borrowings requires borrowers to cover both the principal and coupon payments. The financial hedge must have a minimum tenor of one year and be rolled over periodically to ensure continuous coverage. Furthermore, the hedge must commence from the very day the liability is created in the borrower's books to mitigate currency risk effectively.

11. (A) Prior Government approval is required, with restrictions on defence and space sectors.

A citizen or entity of Pakistan can invest in an Indian entity only under the government route, requiring prior approval. Such investments are strictly prohibited in sensitive sectors like defence, space, and atomic energy. This regulatory requirement ensures that investments from specific jurisdictions undergo thorough scrutiny by the government before capital instruments are issued to residents of those countries.

12. (C) Offsetting exposure must occur within the same accounting year.

A natural hedge is recognized when a borrower has future cash flows in a foreign currency that can offset the External Commercial Borrowing liability. To be valid, these matching foreign currency revenues must be sufficient to cover the debt obligations. Crucially, the offsetting exposure must occur within the same accounting year to qualify as an effective hedge under current regulations.

13. (B) It is prohibited as technology collaboration in the lottery business is not allowed.

Foreign investment and technology collaboration, including the licensing of trademarks or franchise management systems, are strictly prohibited in

the lottery business. This prohibition covers all forms of lottery, including government, private, and online systems. Therefore, any arrangement involving foreign entities providing branding or management services to an Indian company engaged in lottery activities is prohibited under current rules.

14. (C) 70 per cent of the ECB exposure

Infrastructure companies raising External Commercial Borrowings in foreign currency are subject to specific mandatory hedging requirements. According to the guidelines, such entities must hedge at least seventy percent of their total ECB exposure if the average maturity period is less than five years. This measure is designed to protect infrastructure projects from significant currency fluctuations that could affect financial stability.

15. (D) The DER is not adversely affected, and the investor bears the exchange risk.

Issuing Global Depository Receipts involves the issuance of equity shares represented by receipts traded in international markets. Since these are equity instruments, the company's debt-to-equity ratio is not adversely affected; in fact, the equity base increases. The exchange risk associated with the fluctuating value of the receipts in foreign currency is borne entirely by the overseas investor, not the company.

16. (D) USD 750 million

Under the automatic route of the External Commercial Borrowing framework, eligible borrowers are permitted to raise a maximum amount of seven hundred and fifty million US dollars or its equivalent per financial year. This limit allows companies to access international debt markets efficiently without seeking prior regulatory approval, provided they comply with the all-in-cost and minimum average maturity requirements.

17. (B) I and III only

In a Global Depository Receipt arrangement, the underlying equity shares are held by an Indian custodian on behalf of the overseas depository. While the dividend is initially paid in Indian Rupees to the depository, it is subsequently converted and distributed to investors. The

ANSWERS

1. (B) Investment remains FDI; TC maturity is compliant.
Foreign Direct Investment in a listed Indian company is a holding of ten percent or more on a fully diluted basis. Once an investment is classified as FDI, it remains so even if the shareholding subsequently falls below the ten percent threshold. Additionally, trade credits for importing capital goods are permitted for a maturity period up to three years.
2. (B) Only II is correct
ECBs raised for working capital, general corporate purposes, or repayment of Rupee loans cannot be sourced from foreign branches or subsidiaries of Indian banks. However, these borrowings must strictly adhere to the prescribed Minimum Average Maturity Period. This ensures that long-term debt is used for these specific purposes without involving the foreign arms of domestic banking institutions.
3. (A) The total outstanding shares assuming all potential conversion sources are fully exercised.
A fully diluted basis refers to the total number of shares that would be outstanding if all possible sources of conversion are exercised. This includes the conversion of convertible debentures, preference shares, warrants, and employee stock options into equity. It provides a comprehensive view of potential equity ownership by accounting for all instruments that can eventually become ordinary shares.
4. (D) Benchmark rate plus 500 basis points
The all-in-cost ceiling for new External Commercial Borrowings denominated in foreign currency is set at the benchmark rate plus five hundred basis points per annum. This limit includes interest, other fees, expenses, and commitment fees but excludes withholding tax. For existing borrowings transitioning from LIBOR to alternative reference rates, a slightly different spread ensures a smooth regulatory transition.
5. (B) If an existing investment falls below 10% on a fully diluted basis, it remains FDI.
Foreign Direct Investment is categorized based on an initial investment meeting the ten percent threshold in a listed company. According to regulatory guidelines, if an existing investment was classified as FDI, it shall continue to be treated as such even if the holding subsequently falls below ten percent of the post-issue paid-up equity capital on a fully diluted basis.
6. (D) I, II, III, IV, and V
The negative list for External Commercial Borrowing proceeds prohibits their utilization for real estate activities, investment in the capital market, and equity investment. Additionally, using these funds for working capital purposes or the repayment of Rupee loans is generally restricted, unless specific exceptions apply under the current framework. These restrictions ensure that foreign debt is channeled toward productive economic activities.
7. (A) Only I is correct
Foreign investment refers to investments made by persons resident outside India on a repatriable basis in the capital instruments of an Indian company or LLP. While investment in chit funds is generally prohibited, an exception exists for Non-Resident Indians and Overseas Citizens of India, who can invest on a non-repatriation basis, provided the state registrar of chits grants permission.
8. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
Changing the currency of an External Commercial Borrowing from foreign currency into Indian Rupee is freely permitted. The exchange rate for this conversion is determined by the rate prevailing on the date of the agreement or a lower rate if the lender consents. While both statements are factually accurate, the method of determining the exchange rate does not explain the permission.

Indian Rupees, it is not permitted to be converted back into any foreign currency. This restriction maintains the stability of Rupee-denominated debt under foreign exchange rules.

- 27.** (A) 30 days from the date of conversion
When a resident individual in India redeems their Indian Depository Receipts, they receive the underlying equity shares of the issuing foreign company. According to the current regulations, the individual is allowed to hold these shares for a maximum duration of thirty days. The primary purpose of this holding period is to facilitate the sale of those shares in international markets.
- 28.** (C) Up to three years
While the general maturity period for trade credits for non-capital goods is limited to one year or the operating cycle, specific sectors receive exemptions. Shipyards and shipbuilders in India are permitted to raise trade credits for the import of non-capital goods with a maturity period of up to three years from the date of shipment, providing necessary financial flexibility.
- 29.** (B) Commercial loans from non-residents to residents in foreign currency or INR.
External Commercial Borrowings are commercial loans raised by eligible resident entities from recognized non-resident entities. These borrowings can be denominated in either foreign currency or Indian Rupees. They include various instruments such as bank loans, notes, bonds, and debentures, excluding fully and compulsorily convertible instruments which are treated as equity. This framework allows Indian companies to access global capital.
- 30.** (C) RDBs can be issued for PDI qualifying as Additional Tier 1 capital.
Indian banks are permitted to issue Rupee Denominated Bonds overseas for specific purposes, such as raising Perpetual Debt Instruments that qualify as Additional Tier 1 capital under Basel III norms. These instruments allow banks to strengthen their capital base by accessing international investors while keeping the debt denominated in domestic currency, thereby transferring the exchange risk to the overseas buyers.

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- 31.** (D) Registered entities engaged in micro-finance activities are eligible to raise FCY ECB.
While many entities are eligible to raise External Commercial Borrowings, the rules differ between foreign currency and Rupee denominations. Specifically, registered entities engaged in micro-finance activities, such as certain NGOs or societies, are not permitted to raise foreign currency ECBs. They are only allowed to raise borrowings denominated in Indian Rupees to manage their funding requirements from recognized overseas lenders.
- 32.** (B) I, II, and IV
Rupee Denominated Bonds issued overseas can fund infrastructure projects and affordable housing. They also include debt capital instruments that qualify for Tier 2 capital under Basel III guidelines. These bonds must be included within the investment limits set for Foreign Portfolio Investors in corporate bonds. However, there is a cap where not more than seventy-five percent of the eligible amount.
- 33.** (A) I and II only
Recognised lenders for External Commercial Borrowings must be residents of FATF or IOSCO compliant countries. Individuals can act as lenders only if they are foreign equity holders or subscribe to bonds listed abroad. However, foreign branches or subsidiaries of Indian banks are restricted; they are permitted to act as lenders only for foreign currency ECBs and not for Rupee-denominated ones.
- 34.** (A) P-4, Q-3, R-2, S-1
Buyers' credit is a trade credit arranged by banks or financial institutions located outside India. Suppliers' credit, conversely, is arranged directly by the supplier of goods from an overseas location. External Commercial Borrowing refers to commercial loans raised from non-residents, while a fully diluted basis accounts for all potential shares resulting from the conversion of all outstanding instruments.
- 35.** (A) The issuances are made by Indian banks.
Foreign branches or subsidiaries of Indian banks can generally act as arrangers, underwriters, or market-makers for Rupee-denominated bonds issued overseas by Indian entities. However, they are strictly prohibited from participating in any

depository is legally entitled to exercise voting rights as it is the registered holder of the shares.

- 18.** (C) All India Financial Institutions may issue guarantees under the automatic route.

Indian banks and Non-Banking Financial Companies are generally prohibited from providing any form of guarantee for External Commercial Borrowings. Furthermore, current rules emphasize that financial intermediaries shall not invest in or guarantee these instruments. Specifically, the issuance of guarantees by financial institutions under the automatic route is not permitted by regulators to protect the stability of the domestic financial system.

- 19.** (A) P-2, Q-4, R-1, S-3

In the depository receipt mechanism, the overseas investor bears the currency exchange risk. The depository is the entity entitled to voting rights as the holder of the underlying equity shares. Meanwhile, the Indian custodian is responsible for holding these shares locally. Stockbrokers facilitate the process by purchasing shares from the domestic market for conversion into Global or American Depository Receipts.

- 20.** (D) No, the ratio is not applicable for amounts up to USD 5 million.

The External Commercial Borrowing liability-to-equity ratio of seven-to-one is applicable for foreign currency borrowings raised from a direct foreign equity holder under the automatic route. However, this leverage restriction is not applicable if the total outstanding amount of all ECBs, including the proposed borrowing, does not exceed five million US dollars. Therefore, a four million dollar loan is exempt.

- 21.** (B) II, III, and IV

Indian Depository Receipts are denominated in Indian Rupees and issued by foreign companies to investors in India. The proceeds from such issues must be immediately repatriated outside the country. Furthermore, financial companies seeking to issue IDRs must obtain prior approval from their sectoral regulators. These receipts cannot be redeemed into the underlying equity shares before the completion of one year.

- 22.** (A) P-2, Q-3, R-4, S-1

Trade credit regulations specify different limits and tenors based on the type of goods and the industry. For instance, oil and gas refining companies can raise up to one hundred and fifty million dollars per transaction, while other companies are limited to fifty million. The maturity period for capital goods is three years, whereas non-capital goods are limited to one year.

- 23.** (B) Non-Resident Indian (NRI) — Funds held in NRE / FCNR(B) account

Non-Resident Indians are permitted to invest in Indian Depository Receipts using funds held in their Non-Resident External or Foreign Currency Non-Resident (Bank) accounts. This ensures that the investment is made using repatriable foreign exchange. Other investor types, like resident individuals or Foreign Portfolio Investors, must follow their specific funding guidelines, but NRIs are restricted to these account types.

- 24.** (A) I, II, III, and IV

Trade credits for importing capital goods are allowed for up to three years, while non-capital goods are limited to one year or the operating cycle. Shipbuilders benefit from an extended three-year period for non-capital goods. These maturity limits are identical regardless of whether the trade credit is denominated in foreign currency or Indian Rupees, ensuring consistency across financing types.

- 25.** (B) I, II, IV, and V

The limited two-way fungibility of Indian Depository Receipts allows listed Indian companies and mutual funds to hold or sell the underlying shares upon redemption. Resident individuals, however, are permitted to hold the underlying shares only for the purpose of sale. This sale must be completed within thirty days from the date of conversion of the IDRs into the underlying shares.

- 26.** (C) INR TC to any freely convertible foreign currency

In the trade credit framework, borrowers are permitted to change the currency of a foreign currency credit to another freely convertible foreign currency or into Indian Rupees. However, once a trade credit is denominated in

percent of the post-issue paid-up equity capital on a fully diluted basis. This type of investment is generally considered to be for financial gain rather than for strategic control.

45. (B) II and III

Penal interest for default is calculated based on the outstanding principal amount of the loan. Furthermore, the combined charges for prepayment and penal interest are restricted to a maximum of two percent over and above the contracted rate of interest. These costs are generally excluded from the calculation of the all-in-cost ceiling, ensuring that penalties do not breach interest caps.

46. (C) Till the expiry of the block of three years

According to the SEBI Foreign Portfolio Investor Regulations of 2014, any Foreign Institutional Investor holding a valid certificate of registration is deemed to be an FPI. This status remains valid until the expiry of the current block of three years for which the registration fees have been paid. This transition was part of a regulatory effort to simplify the investment framework.

47. (D) Foreign equity holder (subject to an MAMP of 5 years).

While External Commercial Borrowing proceeds are generally prohibited for working capital use, an exception is made for funds raised from a direct foreign equity holder. In such cases, the borrowing must have a minimum average maturity period of five years. This allows companies to leverage their relationship with significant investors to fund day-to-day operations under specific conditions.

48. (D) Chit funds for investments made by NRIs or OCIs on a non-repatriation basis.

Foreign investment is broadly prohibited in several sectors, including lottery businesses, gambling, and trading in transferable development rights. However, a specific exception exists for chit funds. Non-Resident Indians and Overseas Citizens of India are permitted to invest in chit funds on a non-repatriation basis, provided they obtain the necessary permissions from the respective registrar of chits.

49. (B) No, penal interest should not exceed 2% over the contracted rate.

Under the External Commercial Borrowing framework, while penal interest is excluded from the all-in-cost ceiling, it is subject to a specific cap. The regulations state that prepayment charges and penal interest, combined or separately, must not exceed two percent over and above the contracted rate of interest. Therefore, a penal interest of three point five percent would be non-compliant.

50. (C) Lottery Business — Prohibited but foreign technology collaboration is permitted

Foreign technology collaboration, including the licensing of trademarks or franchise names, is strictly prohibited in sectors where foreign investment itself is not allowed. This includes the lottery business, gambling, and betting. While manufacturing cigars for export and certain investments in chit funds are permitted under specific conditions, any form of foreign collaboration in the lottery sector is entirely forbidden.

51. (A) Offsetting cash flows in matching currency, net of all projected outflows.

A natural hedge is a risk management strategy where a borrower offsets the currency risk of an External Commercial Borrowing using future cash inflows in the same foreign currency. This is calculated as the net of all projected foreign currency outflows. It provides a non-derivative method to mitigate exchange rate volatility, provided the matching revenues occur within the same period.

52. (D) It will continue to be treated as Foreign Direct Investment (FDI).

Once a foreign investment in a listed Indian company is classified as Foreign Direct Investment because it met the initial ten percent threshold, it retains that classification. Even if the holding subsequently drops below ten percent on a fully diluted basis due to share dilution or other reasons, the investment continues to be treated as FDI rather than being reclassified.

- 53.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Borrowers are prohibited from converting an External Commercial Borrowing denominated in Indian Rupees back into any foreign currency. At the same time, overseas investors providing Rupee-denominated debt are permitted to hedge their Rupee exposure using various derivative products available in the Indian market. While both provisions are true, the ability to hedge does not explain the conversion prohibition.

- 54.** (C) Negotiable receipts issued abroad representing equity shares of an Indian Company.

Global Depository Receipts are negotiable financial instruments issued by an overseas depository bank. These receipts represent a specific number of equity shares of an Indian company and are traded on international stock exchanges. They allow Indian companies to raise capital from global investors by offering them a convenient way to invest in domestic equity through a foreign-denominated tradable receipt.

- 55.** (B) No, indexed revenues are not considered a valid natural hedge.

According to the hedging guidelines for External Commercial Borrowings, a natural hedge is only recognized if there are actual future cash flows in a matching foreign currency. Revenues that are merely indexed to a foreign currency, but received in local currency, do not qualify as a valid natural hedge. Therefore, such an arrangement does not meet the regulatory hedging requirements.

- 56.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The issuance of Global Depository Receipts leads to an increase in the issuing company's equity capital without adding to its debt obligations. Because the denominator in the debt-to-equity ratio increases while the debt remains constant, the overall ratio is not adversely affected. Thus, the expansion of the equity base directly explains why the debt-to-equity ratio remains stable or improves.

- 57.** (A) Only I is correct

For foreign currency External Commercial Borrowings raised from a direct foreign equity

holder, a maximum liability-to-equity ratio of seven-to-one is prescribed under the automatic route. However, this restriction is relaxed for smaller borrowings. If the total outstanding amount of all ECBs is up to five million US dollars, the seven-to-one leverage ratio does not need to be applied.

- 58.** (B) Soliciting investors for ADRs can be done globally without specific accounting standards compliance.

Soliciting investors for American Depository Receipts requires strict compliance with US accounting standards, such as US GAAP. This is a significant requirement that distinguishes ADRs from other forms of depository receipts. While reissuance and fungibility are permitted under specific rules to maintain original issue levels, the claim that global solicitation can be done without accounting standards compliance is incorrect.

- 59.** (A) The limit was increased from USD 750 million to USD 1.5 billion.

To facilitate greater foreign exchange inflows, a temporary regulatory relaxation was introduced for External Commercial Borrowings under the automatic route. The annual borrowing limit was increased from seven hundred and fifty million US dollars to one point five billion US dollars. This measure, which was available until the end of December 2022, aimed to help Indian companies access larger amounts of capital.

- 60.** (C) It is permitted under limited two-way fungibility within original issue levels.

Under the limited two-way fungibility scheme, a SEBI-registered stockbroker can purchase shares of an Indian company from the domestic market and have them converted back into Global Depository Receipts. This reissuance is permitted as long as the total number of outstanding GDRs does not exceed the original issue size. It provides liquidity and allows for the recycling of existing depository receipts.

- 61.** (B) Credits from overseas for import of goods under the Foreign Trade Policy.

Trade Credits refer to the credits extended by overseas suppliers, banks, and financial institutions for the import of capital or non-capital goods into India. These credits are governed by the Foreign Trade Policy and are intended

specifically for trade-related transactions. They differ from other debt products by being directly linked to the physical movement of goods across borders.

62. (C) USD 5 billion

The issuance of Indian Depository Receipts by eligible foreign companies is subject to an overall aggregate ceiling. This cap is set at five billion US dollars for the raising of capital from the Indian markets. This limit is monitored by the Securities and Exchange Board of India and ensures that the outflow of domestic capital remains within manageable levels.

63. (B) I, II, and IV

Suppliers' credit is provided by the overseas exporter, while buyers' credit is arranged by financial institutions or foreign equity holders. For trade credits, foreign branches of Indian banks are permitted as lenders for foreign currency transactions only. Additionally, the participation of Indian banks from International Financial Services Centres is subject to prudential guidelines issued by the Reserve Bank of India.

64. (B) 1, 2, 3

The regulatory lifecycle of Indian Depository Receipts begins with their issuance by a foreign company through a domestic depository. Following the issue, there is a mandatory one-year lock-in period before the receipts can be redeemed into the underlying equity shares. Once redeemed, resident individuals are permitted to hold the underlying shares for a short period specifically for their sale.

65. (D) I, II, and III

The all-in-cost ceilings for trade credits are structured based on the currency and the type of benchmark used. For new foreign currency trade credits, the limit is the benchmark rate plus three hundred basis points. For Rupee-denominated credits, the spread is two hundred and fifty basis points. Transitioning legacy LIBOR-based credits to alternative rates allows a slightly higher spread. This limit includes interest, other fees, expenses, and commitment fees but excludes withholding tax.

66. (C) FEMA provisions do not apply to the holding of underlying shares by FPIs.

When Indian Depository Receipts are redeemed, the holding of the resulting underlying equity shares by Foreign Portfolio Investors is not governed by the Foreign Exchange Management Act provisions. However, for other residents, such as individuals or mutual funds, specific FEMA rules apply regarding the duration and purpose for which these overseas shares can be held after conversion.

67. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Overseas lenders providing Rupee-denominated trade credits are eligible to hedge their currency exposure in the Indian market. This is facilitated through the foreign branches or subsidiaries of Indian banks, which allow the lenders to manage their risk on a back-to-back basis. Therefore, the availability of this banking mechanism directly enables the hedging capability for these international investors.

68. (D) No, NRIs may invest in IDRs only out of NRE or FCNR(B) accounts.

Non-Resident Indians and Overseas Citizens of India are permitted to invest in Indian Depository Receipts issued by foreign companies. However, the regulations specify that the funds for such investments must originate from repatriable accounts, namely Non-Resident External (NRE) or Foreign Currency Non-Resident (Bank) accounts. Investing from a non-repatriable Non-Resident Ordinary account is not permitted for this instrument.

69. (D) USD 150 million

Under the automatic route for trade credits, oil and gas refining companies are granted a higher limit compared to other sectors due to the high value of their import transactions. They are permitted to raise up to one hundred and fifty million US dollars or its equivalent for a single import transaction, facilitating the procurement of essential energy resources.

70. (B) I, III, IV, and V

The External Commercial Borrowing framework permits several debt instruments, including fixed or floating rate notes, bonds, and debentures. It

also covers financial leases and trade credits with a maturity exceeding three years. Plain vanilla Rupee-denominated bonds issued overseas are also included. However, fully and compulsorily convertible instruments are excluded from the ECB category as they are treated as equity.

71. (C) Both I and II are correct

The 'eligible amount' for an Indian bank to issue Perpetual Debt Instruments in foreign currency is determined as of March thirty-first of the preceding financial year. This amount is calculated by taking the higher of one point five percent of the bank's total Risk Weighted Assets or the total value of its Additional Tier 1 capital.

72. (A) P-2, Q-4, R-3, S-1

Rupee-denominated External Commercial Borrowings are denominated in Indian currency and can include instruments like plain vanilla bonds issued overseas. Registered not-for-profit companies are among the eligible borrowers for this type of funding. Recognised lenders include foreign branches or subsidiaries of Indian banks, provided they comply with all applicable prudential norms and guidelines for such international lending.

73. (C) Assertion (A) is true, but Reason (R) is false.
Rupee Denominated Bonds issued overseas are debt instruments and are included within the investment limits set for Foreign Portfolio Investors in domestic corporate bonds. The reason provided is incorrect because these bonds do not represent equity shares; they are commercial loans in the form of tradable debt securities. Therefore, while the assertion is true, the supporting reason is factually incorrect.

74. (B) Permitted as lenders for FCY ECB and as arrangers for Rupee Bonds overseas.

Foreign branches and subsidiaries of Indian banks are permitted to act as recognized lenders for External Commercial Borrowings denominated in foreign currency. They are also allowed to participate as arrangers or underwriters for Rupee-denominated bonds issued overseas by Indian entities, except for those issued by Indian banks. This policy balances support for Indian companies with prudential risk management.

75. (A) I, II, III, and V

Foreign investment is restricted in sectors like lottery and real estate. Global Depository Receipts and Indian Depository Receipts are key international equity-linked instruments for raising capital. While the borrower bears the exchange risk in foreign currency External Commercial Borrowings, the automatic route for trade credits allows most sectors to raise up to fifty million dollars for import requirements.

76. (C) INR ECB only

Registered societies and other entities engaged in micro-finance activities are eligible to raise External Commercial Borrowings to fund their operations. However, to manage currency risk, these organizations are restricted to raising such borrowings only in Indian Rupees. They are not permitted to raise debt in foreign currency, ensuring that their repayment obligations are not affected by exchange rate volatility.

77. (B) 12 months tenor and benchmark plus 250 basis points.

Trade credits for the import of non-capital goods are generally restricted to a maximum maturity period of one year or the operating cycle, whichever is less. The all-in-cost ceiling for these transactions is capped at the benchmark rate plus two hundred and fifty basis points. This ensures that short-term trade financing remains affordable and aligned with current market standards.

78. (A) P-4, Q-1, R-3, S-2

Minimum average maturity periods for External Commercial Borrowings depend on the use of funds. Manufacturing companies raising up to fifty million dollars have a one-year requirement. General corporate purposes from foreign equity holders require five years. Repayment of Rupee loans for capital expenditure needs seven years, while Non-Banking Financial Companies on-lending for working capital must maintain ten.

79. (D) Dividends for GDRs are paid out in foreign currency to the Depository.

While many aspects of international funding are correctly stated, the payment of dividends for Global Depository Receipts involves a specific process. The Indian company pays the dividend in Indian Rupees to the domestic custodian. The

depository then converts these funds into foreign currency to distribute them to overseas investors. Thus, the dividend is not initially paid in foreign currency.

80. (D) Manufacturing companies up to USD 50 million — MAMP 5 years

The regulatory framework provides specific maturity periods for various categories of External Commercial Borrowings. While working capital from foreign equity holders requires five years and repayment of Rupee loans for capital expenditure requires seven years, manufacturing companies are allowed a significant concession. They can raise up to fifty million dollars with a minimum average maturity period of only one year.

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CHAPTER 22

Funding and Regulatory Aspects

May/June 2016

1. Two banks operating in India need to send authenticated messages for transferring funds domestically. They utilize a communication backbone that facilitates structured messaging. Which system are the banks using?
(A) Real Time Gross Settlement System (RTGS)
(B) Negotiated Dealing System - Order Matching (NDS-OM)
(C) Structured Financial Messaging System (SFMS) over the INFINET
(D) Asian Clearing Union (ACU) Electronic Messaging System

Oct/Nov 2009

2. Identify the incorrect pair concerning the payment and settlement systems.
(A) RTGS : Settlements on a gross basis without day-end net settlement of cheques
(B) NDS : An electronic platform for facilitating dealing in government securities
(C) INFINET : A secure worldwide financial messaging system exclusive to banks
(D) FX Clear : A system for foreign exchange transactions developed by CCIL

May/June 2023

3. How is 'liquidity' defined in the context of the banking system and the real economy?
(A) Surplus funds available with banks that have not been absorbed by the real economy
(B) The ratio of physical cash held by the public to the total demand deposits of banks
(C) The funds permanently impounded by the central bank to eliminate inflationary pressure
(D) The value of gold and approved securities held against foreign exchange reserve pools

Oct/Nov 2018

4. Consider the following statements regarding the cost of maintaining reserve assets:
I. RBI pays interest on deposits held by banks to meet the CRR, provided the deposits are in excess of the minimum required.

- II. Because RBI does not pay interest on CRR deposits, it effectively increases the cost of deposits to the banking sector.

Which of the above statement(s) is/are correct?

- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

May/June 2007

5. Which of the following defines 'Anonymous Trading' in the financial markets?
(A) A facility where physical delivery of cheques is executed without verifying user signatures
(B) A mechanism for payment to and from members of the Asian Clearing Union central banks
(C) Overseas offices of banks rendering special banking services with unrecorded transactions
(D) A screen-based system matching orders without revealing participant identity until settled

Oct/Nov 2025

6. Consider the following statements regarding the Negotiated Dealing System - Order Matching (NDS-OM):
I. The NDS-OM system allows straight-through processing (STP) and trades executed flow straight to CCIL for settlement.
II. Physical delivery of cheques and written confirmations are strictly necessary for the settlement of repo trades done on NDS.
Which of the above statement(s) is/are correct?
(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

May/June 2012

7. What is the minimum bid amount required for a bank to submit a repo transaction with RBI under the Liquidity Adjustment Facility (LAF)?

NODIA

- (A) Rs. 1 crore
- (B) Rs. 2 lakhs
- (C) Rs. 5 crore
- (D) Rs. 10 crore

Oct/Nov 2014

8. Consider the following types of assets used for maintaining the Statutory Liquidity Ratio (SLR):
- I. Cash balances including those maintained for CRR
 - II. Gold valued at a price not exceeding the current market price
 - III. Approved securities valued as per norms prescribed by RBI
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II and III

May/June 2019

9. On which date was the Standing Deposit Facility (SDF) operationalised?
- (A) 6th February 2015
 - (B) 14th February 2020
 - (C) 1st April 2021
 - (D) 8th April 2022

Oct/Nov 2006

10. Consider the following statements regarding electronic payments and the Structured Financial Messaging System (SFMS):
- I. SFMS is similar to the SWIFT system adopted by banks for international funds transfer.
 - II. Interbank transfers via NEFT and online payments are sorted out and cleared by the National Clearing Cell of RBI.
 - III. SFMS facilitates international transfer of funds and authenticated messages.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II and III

May/June 2021

11. By moving either side of the policy rate corridor without directly regulating the rates, what does the RBI achieve?
- (A) Flexibility to adjust short-term interest rates using Repo as a market-based policy

instrument

- (B) Comprehensive risk mitigation for counterparty defaults in the inter-bank electronic payments
- (C) Guaranteed physical delivery of all government securities traded within the secondary market
- (D) Instant conversion of bank Time Liabilities into Demand Liabilities to meet liquidity stress

Oct/Nov 2010

12. Consider the following statements concerning the rules for Cash Reserve Ratio (CRR) compliance among different types of banks:
- I. The flexibility of maintaining a daily minimum of 90% is available to Scheduled Commercial Banks, Payments Banks, and Small Finance Banks.
 - II. Urban Cooperative Banks are allowed the 90% daily minimum flexibility for CRR.
 - III. Scheduled Commercial Banks maintain CRR in the form of RBI Balances only.
 - IV. Branch Cash Balances are eligible to be reckoned as CRR for Urban Cooperative Banks.
- Which of the above statement(s) is/are correct?
- (A) I, II and III only
 - (B) I, III and IV only
 - (C) II, III and IV only
 - (D) I, II, III and IV

May/June 2005

13. How does the settlement mechanism of RTGS differ conceptually from conventional clearing house methods?
- (A) Settlements are strictly paper-based and take 1 to 3 days to clear
 - (B) Settlements are on a gross basis instantly, rather than day-end net settlement of cheques
 - (C) Settlements occur on a net basis at day-end rather than continuously
 - (D) Settlements are exclusively for government securities and not for customer remittances

Oct/Nov 2022

14. Consider the following statements regarding the Marginal Standing Facility (MSF):
- I. The MSF rate lays the upper side of the policy rate corridor.
 - II. Individual banks can draw funds up to

policy is to narrow the policy rate corridor formed by the MSF and SDF rates.

Reason (R): Narrowing the policy rate corridor ensures finer alignment of the weighted average call rate (WACR) with the repo rate.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

27. What is the twin objective of the monetary policy of the RBI?

- (A) Controlling the rate of inflation and ensuring stability of financial markets
- (B) Maximizing bank profitability and reducing non-performing assets
- (C) Eliminating physical currency and fully adopting digital payments
- (D) Targeting a specific exchange rate for the Rupee and eliminating the LAF corridor

Oct/Nov 2015

28. Bank Alpha fails to maintain the daily Cash Reserve Ratio (CRR) balance on Monday. The shortfall amount for that day is Rs. 50 crores. If the current Bank Rate is 5% p.a., what will be the penal interest rate applied by the RBI for the shortfall on Monday?

- (A) 3% p.a.
- (B) 5% p.a.
- (C) 8% p.a.
- (D) 10% p.a.

May/June 2013

29. Which of the following best distinguishes the Liquidity Adjustment Facility (LAF) from CRR and SLR?

- (A) CRR and SLR apply only to foreign banks, while LAF applies to domestic banks.
- (B) LAF monitors daily liquidity, whereas CRR/SLR influence long-term policy stance.
- (C) LAF requires banks to hold unencumbered approved government securities, whereas SLR requires cash deposits with RBI.
- (D) LAF imposes heavy penalties for defaults on a fortnightly basis, while CRR and SLR are monitored hourly.

Oct/Nov 2021

30. Bank Beta has an average required CRR amount of Rs. 10,000 crores for the fortnight. Based on RBI regulations for Scheduled Commercial Banks, will Bank Beta attract a penalty if cash balances with RBI fall to Rs. 9,300 crores on Wednesday?

- (A) Yes, because the balance fell below 100% of the required CRR amount.
- (B) Yes, because the minimum daily maintenance threshold for banks is 95%.
- (C) No, because the bank is allowed a daily minimum threshold of 90%.
- (D) No, because penalties are calculated based strictly on 14-day averages.

May/June 2024

31. What is the most appropriate description of the Clearing Corporation of India Ltd. (CCIL)?

- (A) An apex financial institution that provides refinance to rural sectors
- (B) A sub-committee of the RBI Central Board that regulates payment systems
- (C) A sovereign body that issues physical currency notes
- (D) A specialized body for clearing securities, repo trades, and TREPS

Oct/Nov 2008

32. The treasury desk of Bank Gamma wishes to participate in a Repo auction with the RBI. The dealer attempts to submit a bid for Rs. 12 crores. According to LAF guidelines, what is the fate of this bid?

- (A) The bid will be accepted as it exceeds the absolute minimum of Rs. 1 crore.
- (B) The bid will be accepted only if placed during the Marginal Standing Facility window.
- (C) The bid will be modified automatically by the RBI system to exactly Rs. 10 crores.
- (D) The bid will be rejected as it must be in multiples of Rs. 5 crore.

May/June 2006

33. Arrange the introduction of the following financial systems/facilities by RBI in chronological order from earliest to latest:

- I. Real Time Gross Settlement System (RTGS)
- II. Negotiated Dealing System (NDS)
- III. Standing Deposit Facility (SDF)
- IV. NDS - OM (Order Matching)

currently results in a cash inflow of approx. Rs. 80-85000 crore into the money market.

- III. RBI pays interest on deposits held by banks to meet CRR up to a limit of 90%.
- IV. Default in meeting CRR and SLR attracts heavy penalties and affects the bank's reputation.
- V. Money at Call and Short Notice from outside the banking system shall be shown against liability to others.

Which of the above statement(s) is/are correct?

- (A) I, II, IV and V only
- (B) I, II, III and IV only
- (C) II, III, IV and V only
- (D) I, III, IV and V only

May/June 2009

21. Which of the following statements about the Treasury's reporting responsibility for CRR and SLR is incorrect?
- (A) Treasury's primary responsibility is to meet the CRR and SLR requirements of the bank fully.
 - (B) Treasury back-office must report relevant information to RBI in the fortnightly return known as Form A.
 - (C) Shortfalls in meeting the requirements attract serious penalties from the RBI.
 - (D) Reporting to RBI is done daily via the Structured Financial Messaging System instead of Form A.

Oct/Nov 2011

22. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these statements and select the correct answer using the options provided.

Assertion (A): The reserve money impounded by RBI by means of the Cash Reserve Ratio (CRR) is intended to reduce the money multiplier effect.

Reason (R): CRR removes a portion of the cash deposits from the banking system, thereby restricting the chain of relending and creating new deposits.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.

(D) Assertion (A) is false, but Reason (R) is true.

May/June 2010

23. All of the following are included under Time Liabilities of a bank, except:
- (A) Cash certificates
 - (B) Outstanding Telegraphic Transfers (TTs) and Mail Transfers (MTs)
 - (C) Cumulative and recurring deposits
 - (D) Staff security deposits

Oct/Nov 2024

24. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these statements and select the correct answer using the options provided.

Assertion (A): Banks participating in RTGS need to maintain adequate funds with RBI throughout the day.

Reason (R): RTGS involves instant payments on a gross basis, and to meet any shortfall, RBI provides intra-day liquidity through automatic repo against lodged securities.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2017

25. The Statutory Liquidity Ratio (SLR) is to be maintained in the form of the following assets, except:

- (A) Balances maintained for CRR
- (B) Cash balances (excluding balances maintained for CRR)
- (C) Gold valued at a price not exceeding the current market price
- (D) Approved securities valued as per norms prescribed by RBI

Oct/Nov 2005

26. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these statements and select the correct answer using the options provided.

Assertion (A): The objective of RBI monetary

Oct/Nov 2020

40. A large corporate client deposits a sum as a margin against a letter of credit. The terms of the deposit state that the margin is not payable on demand. Under which category must the bank classify this margin money when computing its Net Demand and Time Liabilities?
- (A) Time Liabilities
(B) Current deposits
(C) Exclusions from the CRR stipulation
(D) Demand Liabilities

May/June 2022

41. Identify the incorrect pair concerning the treatment of specific liabilities for the purpose of CRR.
- (A) Credit balances in ACU (US\$) Accounts : Included in the CRR stipulation
(B) Paid-up capital and reserves : Excluded from the CRR stipulation
(C) Claims received from DICGC and ECGC : Excluded from the CRR stipulation
(D) Net unrealized gain/loss from derivatives under trading portfolio : Excluded from the CRR stipulation

Oct/Nov 2023

42. The creation of money through the banking system, where cash deposited in banks is lent out and a part of that borrowed money is held in a deposit account, continuing the chain of relending and creating new deposits, is referred to as which of the following?
- (A) Broad Money Supply
(B) Money Multiplier Effect
(C) Liquidity Adjustment Facility
(D) Statutory Liquidity Ratio

May/June 2016

43. Consider the following statements regarding the maintenance of Cash Reserve Ratio (CRR):
- I. Banks must maintain average daily cash balances not falling below 90% of the required amount for CRR during the fortnight.
II. The flexibility to maintain 90% minimum daily balance is available to Scheduled Commercial Banks and Urban Cooperative Banks alike.
- Which of the above statement(s) is/are correct?
- (A) I only
(B) II only

- (C) Both I and II
(D) Neither I nor II

Oct/Nov 2009

44. What does the Liquidity Adjustment Facility (LAF) refer to?
- (A) An electronic platform for facilitating dealing in government securities on a negotiated basis
(B) A mandatory deposit held by banks with the central bank as a percentage of Net Demand and Time Liabilities
(C) RBI lending funds to the banking sector through the Repo instrument and accepting surplus funds under Reverse Repo
(D) The net settlement of cheques in a clearing house at the end of the day

May/June 2023

45. Consider the following statements regarding repo transactions under the Liquidity Adjustment Facility (LAF):
- I. Under a Repo auction, RBI purchases securities from banks with an agreement to sell back the securities after a fixed period.
II. During these transactions, the physical transfer of securities takes place between the bank and the RBI.
- Which of the above statement(s) is/are correct?
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

Oct/Nov 2018

46. What was the approximate percentage of the most liquid form of money (M1) out of the money supply indicated by M3 for the period 2020-21?
- (A) 10.65%
(B) 18%
(C) 25%
(D) 40%

May/June 2007

47. Consider the following statements regarding liabilities and their exclusion from the CRR stipulation:
- I. Net income tax provision is excluded from the CRR stipulation.
II. Demand and Time Liabilities in respect of Offshore Banking Units (OBUs) are

- (A) I, II, IV, III
- (B) II, I, IV, III
- (C) II, IV, I, III
- (D) I, IV, II, III

Oct/Nov 2017

34. Bank Epsilon is bidding under the Variable Rate Repo window. The bank quotes a rate slightly lower than the prevailing Repo Rate to ensure cost-efficiency. What will be the outcome of this bidding strategy?
- (A) The bid will be successful because the lowest yield stands a better chance of getting funds.
 - (B) The bid will be accepted, but the RBI will allocate only 50% of the requested volume.
 - (C) The bid will be rejected as banks must quote at or above the Repo Rate.
 - (D) The bid will be shifted to the Marginal Standing Facility automatically.

May/June 2008

35. Match the LAF instruments in List I with their corresponding periodicity/timing in List II.
- List I: (LAF Instruments)
- P. 14-day variable-rate repo
 - Q. Variable Rate Term Repo
 - R. Fixed Rate Reverse Repo
 - S. Marginal Standing Facility (MSF)
- List II: (Periodicity/Timing)
- 1. Daily (Including Saturdays, Sundays and holidays)
 - 2. On reporting Friday (2.30 PM – 3.00 PM)
 - 3. Discretionary
 - 4. Between 5.30 PM and 11.59 PM
- (A) P-2, Q-3, R-1, S-4
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-2, R-4, S-1
 - (D) P-4, Q-1, R-3, S-2

Oct/Nov 2013

36. A retail customer requests an immediate electronic transfer of Rs. 1.5 lakhs to a supplier. The branch official refuses to process this through RTGS. What is the regulatory justification for this refusal?
- (A) RTGS transactions are cleared only at day-end, preventing any immediate transfer.
 - (B) RTGS is exclusively reserved for the settlement of sovereign government securities.
 - (C) Retail customers are prohibited from using RTGS; only corporate accounts are eligible.

- (D) The minimum amount for customer remittances under RTGS is Rs. 2 lakhs.

May/June 2015

37. Match the keywords in List I with their definitions in List II.

List I: (Keywords)

- P. Asian Currency Unit (ACU)
- Q. Offshore Banking Units
- R. SWIFT
- S. Depository

List II: (Definitions)

- 1. A secure worldwide financial messaging system exclusive to banks
 - 2. A company where securities are held in electronic form
 - 3. A mechanism for payment to/from members like Bangladesh, Bhutan, India, Iran, etc.
 - 4. Designated domestic offices rendering special banking services only to overseas customers
- (A) P-3, Q-4, R-1, S-2
 - (B) P-4, Q-3, R-2, S-1
 - (C) P-2, Q-1, R-3, S-4
 - (D) P-1, Q-2, R-4, S-3

Oct/Nov 2012

38. Bank Theta conducts high-frequency foreign exchange transactions involving USD/INR pairs. Which settlement intermediary provides straight-through processing and settles these deals on a net basis?
- (A) The Institute for Development and Research in Banking Technology (IDRBT)
 - (B) The National Securities Depository Ltd. (NSDL) clearing platform
 - (C) The Clearing Corporation of India Ltd. (CCIL) via the FX Clear system
 - (D) The National Clearing Cell of RBI via the electronic SFMS network

May/June 2011

39. Identify the correct pair among the following options regarding the monetary aggregates and their components.
- (A) Narrow Money : M1
 - (B) Money Multiplier : M3 divided by Reserve Money (M0)
 - (C) Most liquid form of money : M1
 - (D) Broad Money : M3

Excess SLR + 2 per cent below SLR.

- III. MSF operations face a strict restriction on the maximum amount a single bank can bid annually.
- IV. The facility operates daily, including Saturdays, Sundays, and holidays, between 5.30 PM and 11.59 PM.

Which of the above statement(s) is/are correct?

- (A) I, II and III only
- (B) I, II and IV only
- (C) II, III and IV only
- (D) I, III and IV only

May/June 2018

15. Which components accurately constitute 'Broad Money' or M3?
- (A) Only the physical currency in circulation and cash held in currency chests.
 - (B) Exclusively the credit availed by the commercial sector and the government.
 - (C) The net foreign currency assets of RBI and the paid-up capital of scheduled commercial banks.
 - (D) Currency in circulation, demand deposits with banks, and time deposits with banks.

Oct/Nov 2016

16. Consider the following statements regarding Call, Notice, and Term Money Operations:
- I. The RBI has imposed a rigid statutory ceiling on every individual bank's borrowing in the call/notice money market.
 - II. RBI has left it to the individual entity's Board to fix lending limits in Call and Term Money markets.
 - III. Banks and Primary Dealers can lend in these markets within limits set by their internal Boards.
 - IV. The Master Directions for Call, Notice, and Term Money Operations were issued in April 2021.

Which of the above statement(s) is/are correct?

- (A) I, II and III only
- (B) II, III and IV only
- (C) I, III and IV only
- (D) I, II, III and IV

May/June 2014

17. In view of the growing complexities in payment systems, what specific body has the RBI constituted at the highest level?
- (A) The Clearing Corporation of India Ltd.

(CCIL) Supervisory Board

- (B) The Board for Regulation and Supervision of Payment and Settlement Systems
- (C) The Institute for Development and Research in Banking Technology (IDRBT)
- (D) The National Securities Depository Advisory Committee

Oct/Nov 2007

18. Consider the following statements concerning the instruments under the LAF framework and RBI liquidity measures:
- I. The Export Credit Refinance facility was phased out from 6th February 2015.
 - II. Under Variable Rate Repo, liquidity is provided for 7 days, 14 days, and 28 days.
 - III. The limit fixed by RBI for the Term Repos window is 0.75% of NDTL of the banking system.
 - IV. A bank quoting a rate equal to or above the Repo Rate can avail funds under the Variable Rate Repo route.
 - V. The bank which has quoted the lowest yield stands a better chance of getting funds under the Term Repo window.

Which of the above statement(s) is/are correct?

- (A) I, II, III and IV only
- (B) I, III, IV and V only
- (C) II, III, IV and V only
- (D) I, II, IV and V only

May/June 2025

19. Which statement regarding the Standing Deposit Facility (SDF) is incorrect?
- (A) The SDF replaced the Marginal Standing Facility as the maximum rate for overnight borrowing
 - (B) It was operationalised with effect from 8th April 2022.
 - (C) It replaced the Fixed Rate Reverse Repo (FRRR) as the floor of the LAF corridor.
 - (D) All LAF participants are eligible to participate in SDF.

Oct/Nov 2019

20. Consider the following statements regarding funding and regulatory aspects in the banking sector:
- I. Treasury's primary responsibility is compliance with CRR and SLR requirements.
 - II. A 0.5% reduction in CRR requirement

excluded from the CRR stipulation.

- III. Subsidy released by NABARD under the Investment Subsidy Scheme for Rural Godowns is excluded from the CRR stipulation.

Which of the above statement(s) is/are correct?

- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II and III

Oct/Nov 2025

48. From which month and year has the Real Time Gross Settlement System (RTGS) been fully activated by the Reserve Bank of India?
- (A) February 2002
(B) August 2003
(C) October 2004
(D) August 2005

May/June 2012

49. Consider the following features of the Long Term Variable Rate Repo (LTR) under the LAF framework:
- I. The tenor is beyond 14 days.
II. The auction amount is decided by the Reserve Bank based on an assessment of liquidity conditions.
III. The periodicity and timing of LTR auctions are daily between 5.30 PM and 11.59 PM.
- Which of the above statement(s) is/are correct?
- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II and III

Oct/Nov 2014

50. As the money multiplier effect reduces the importance of currency in circulation, the note issuing role of RBI functions more as which of the following?
- (A) A direct monetary control function to regulate the total volume of money in the system
(B) A quantitative tool for liquidity absorption through the issuance of central bank debt
(C) A utility service to replenish physical currency stocks for the convenience of the public
(D) A mechanism to dictate the exchange rate of the Rupee against a basket of currencies

May/June 2019

51. Consider the following statements regarding the Asian Currency Unit (ACU):
- I. It is a mechanism for payment to and from members such as India, Iran, Maldives, Nepal, and Sri Lanka.
II. The mechanism operates by debit/credit to the ACU Dollar account maintained with a correspondent bank.
III. Credit balances in ACU (US\$) Accounts are exempted from the CRR maintenance for Scheduled Commercial Banks.

Which of the above statement(s) is/are correct?

- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II and III

Oct/Nov 2006

52. In the context of secondary market deals in equity and debt paper, how does the Delivery vs. Payment (DVP) system eliminate settlement risk?
- (A) By settling payments purely on a net basis at the end of a fortnight
(B) By masking the identity of the counter-party until the trade is executed
(C) By requiring the physical delivery of cheques and written confirmations prior to trade
(D) By ensuring funds and securities transfers occur on the electronic platform simultaneously

May/June 2021

53. Consider the following statements regarding the Standing Deposit Facility (SDF):
- I. SDF replaced the fixed rate reverse repo (FRRR) as the floor of the LAF corridor.
II. It was operationalised with effect from 8th April 2022.
III. Under SDF, eligible entities can place deposits with the RBI on an overnight basis.
IV. The SDF rate was laid as the upper side of the corridor, replacing the MSF rate.
- Which of the above statement(s) is/are correct?
- (A) I, II and III only
(B) I, III and IV only
(C) II, III and IV only
(D) I, II and IV only

NODIA

9. (D) 8th April 2022
The Standing Deposit Facility was introduced as a tool for liquidity absorption without the need for collateral. It was officially operationalized on April 8, 2022, following an announcement in the monetary policy review. This facility replaced the fixed rate reverse repo as the floor of the liquidity adjustment facility corridor, providing more flexibility in managing system liquidity.
10. (A) I and II only
The Structured Financial Messaging System provides a platform for secure domestic financial communication, much like SWIFT does globally. It handles interbank transfers and online payments, which are subsequently cleared by specialized clearing cells. Unlike SWIFT, SFMS is designed for the domestic Indian financial market and does not primarily facilitate international fund transfers or global authenticated messaging.
11. (A) Flexibility to adjust short-term interest rates using Repo as a market-based policy instrument
The Reserve Bank manages system liquidity and interest rates by adjusting the repo rate and the bounds of the policy rate corridor. This approach allows the central bank to influence short-term interest rates in the market through a market-based policy instrument. It provides the necessary flexibility to respond to economic conditions without resorting to direct regulatory fixing.
12. (B) I, III and IV only
Scheduled Commercial Banks, Payments Banks, and Small Finance Banks are allowed to maintain a daily minimum of ninety percent of the required Cash Reserve Ratio. While commercial banks hold these reserves exclusively with the regulator, Urban Cooperative Banks can include branch cash balances. However, the ninety percent daily minimum flexibility is not extended to all Urban Cooperative Banks.
13. (B) Settlements are on a gross basis instantly, rather than day-end net settlement of cheques
Real Time Gross Settlement represents a continuous process of settling payments on an individual order basis rather than netting them. Unlike traditional clearing houses that settle cheques on a net basis at the end of the day, RTGS ensures that funds are transferred immediately and finality of settlement is achieved throughout the business day for each transaction separately.
14. (B) I, II and IV only
The Marginal Standing Facility serves as the upper bound of the policy rate corridor and allows banks to borrow overnight funds against government securities. It operates daily, including holidays, during specified evening hours. Banks can utilize this facility to draw funds up to a certain percentage of their statutory liquidity ratio holdings, helping manage unexpected liquidity shocks effectively.
15. (D) Currency in circulation, demand deposits with banks, and time deposits with banks
Broad Money, commonly referred to as M3, is a comprehensive measure of the total money supply in an economy. It includes the most liquid assets like physical currency in circulation and demand deposits held with the banking system. Additionally, it incorporates time deposits, which are less liquid but contribute significantly to the overall financial resources available.
16. (B) II, III and IV only
Current regulations allow individual bank boards to set their own lending limits in the call and term money markets. While there are prudential limits on borrowing to ensure stability, lending is largely managed through internal board policies. Master directions issued in April 2021 govern these operations, providing a framework for banks and primary dealers to manage short-term liquidity.
17. (B) The Board for Regulation and Supervision of Payment and Settlement Systems
To address the increasing complexity and volume of electronic transactions, the central bank established a specialized body known as the Board for Regulation and Supervision of Payment and Settlement Systems. Functioning as a sub-committee of the central board, it focuses on the oversight, policy formulation, and technical standards required for secure and efficient payment infrastructure in India.
18. (A) I, II, III and IV only
The liquidity adjustment framework includes various instruments like variable rate repos with different tenors. The limit for term repos

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- V. Physical delivery of cheques and written confirmations remains a mandatory backup for CCIL settlements.

Which of the above statement(s) is/are correct?

- (A) I, II, III and IV only
(B) I, III, IV and V only
(C) II, III, IV and V only
(D) I, II, III and V only

Oct/Nov 2007

60. Identify the incorrect statement pertaining to the Negotiated Dealing System - Order Matching (NDS-OM).
- (A) It was launched by RBI in August 2005 as an improvement over NDS.
(B) The system is purely order driven, with all orders being matched strictly on price/time priority.
(C) Counter-party identity is disclosed to all participants prior to price acceptance.
(D) It coexists with the telephone-based trading mechanism on NDS.

May/June 2025

61. Consider the following statements regarding Depository and Settlement structures:
- I. Settlement refers to the payment/receipt in exchange of securities or foreign exchange.
II. NSDL and CSDL provide Delivery vs. Payment (DVP) for secondary market deals in equity and debt paper.
III. Under DVP, since funds transfer and securities transfer take place simultaneously on an electronic platform, settlement risk is eliminated.
IV. The RBI constituted the Board for Regulation and Supervision of Payment and Settlement Systems as a sub-committee of its Central Board.
V. Offshore Banking Units render special banking services only to overseas customers with a stand-alone accounting system.

Which of the above statement(s) is/are correct?

- (A) I, II, III and V only
(B) I, II, III and IV only
(C) II, III, IV and V only
(D) I, III, IV and V only

Oct/Nov 2019

62. All of the following are components of Demand Liabilities, except:
- (A) Balances in overdue fixed deposits

- (B) Unclaimed deposits
(C) Gold deposits
(D) Credit balances in the Cash Credit account

May/June 2009

63. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these statements and select the correct answer using the options provided.

Assertion (A): RBI uses Repo as a market-based instrument or benchmark rate to carry out its policy objectives.

Reason (R): By moving either side of the corridor, RBI directly regulates and fixes the specific short-term interest rates without achieving flexibility.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2011

64. All of the following liabilities are excluded from the CRR stipulation, except:
- (A) Net unrealized gain/loss arising from derivatives transaction under trading portfolio
(B) Subsidy released by NABARD under Investment Subsidy Scheme
(C) Refinance availed from RBI and apex financial institutions like NABARD and SIDBI
(D) Demand liabilities portion of savings bank deposits

May/June 2010

65. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these statements and select the correct answer using the options provided.

Assertion (A): In the secondary market deals handled by Depository Institutions like NSDL, the settlement risk is completely eliminated.

Reason (R): Depository Institutions utilize a Delivery vs. Payment (DVP) system where funds transfer and securities transfer take place on the

Oct/Nov 2010

54. Which of the following statements correctly describes the legislative changes made regarding the limits of the Cash Reserve Ratio (CRR)?
- An amendment to the Banking Regulation Act in 2006 established a new floor of 5% and a ceiling of 25% for CRR.
 - The floor and ceiling limits for CRR were strictly enforced by an amendment in January 2007 to curb inflation.
 - An amendment to the RBI Act in 2006 removed the floor and ceiling limits, enabling RBI discretion.
 - The maximum level of CRR was permanently fixed at 40% under the Banking Regulation Act of 1949.

May/June 2005

55. Consider the following statements concerning the Negotiated Dealing System - Order Matching (NDS-OM) system:
- It is an anonymous order matching system where the identity of the counter-party is not disclosed till the price/volume is accepted.
 - The system is purely order driven, matching orders strictly on price/time priority.
 - NDS-OM completely replaced and phased out the telephone-based trading mechanism on NDS.
 - It allows straight-through processing (STP) with trades flowing straight to CCIL for settlement.
- Which of the above statement(s) is/are correct?
- I, II and III only
 - I, III and IV only
 - I, II and IV only
 - II, III and IV only

Oct/Nov 2022

56. Which statement accurately reflects the functioning of FX Clear?
- A forex system by CCIL providing straight-through processing for USD/INR deals on a net basis
 - An inter-bank messaging system that replaces SWIFT for all domestic currency transfer protocols
 - A sub-committee of the Central Board designed to regulate physical currency imports and exports
 - A repository that holds government securities in electronic form for overnight

borrowing needs

May/June 2018

57. Analyze the following items regarding Demand Liabilities, Time Liabilities, and CRR Exclusions:
- Unclaimed deposits are classified as Demand Liabilities.
 - Gold deposits are classified as Time Liabilities.
 - Staff security deposits are classified as Demand Liabilities.
 - Bills rediscounted by a bank with eligible financial institutions are excluded from CRR.
 - District Rural Development Agency (DRDA) subsidy of Rs. 10,000 kept in the Subsidy Reserve Fund is excluded from CRR.
- Which of the above statement(s) is/are correct?
- I, II, IV and V only
 - I, III, IV and V only
 - II, III, IV and V only
 - I, II, III, IV and V

Oct/Nov 2016

58. Which of the following statements regarding the liabilities excluded from the CRR stipulation is incorrect?
- Paid-up capital, reserves, and retained profits are excluded from the CRR stipulation.
 - Credit balances in ACU (US\$) Accounts are included in the CRR stipulation.
 - Net income tax provision is excluded from the CRR stipulation.
 - Claims received from DICGC and ECGC are excluded from the CRR stipulation.

May/June 2014

59. Consider the following statements concerning the evolution of payment and settlement systems:
- RTGS settles inter-bank payments and customer remittances instantly on a gross basis.
 - The minimum amount for customer remittances under RTGS is currently Rs. 2 lakhs.
 - IDRBT developed the Indian Financial Net Work (INFINET) as a secure communication backbone.
 - NDS was introduced in February 2002 to achieve automatic electronic reporting and settlement of government securities.

calculation

- (A) I, II, III, IV
- (B) II, I, IV, III
- (C) IV, III, II, I
- (D) III, I, IV, II

May/June 2024

73. At the end of the business day, Bank Delta identifies that it has significant excess funds that have not been absorbed by the inter-bank market. Under the revised LAF framework operationalized on 8th April 2022, which facility should the bank use to place these overnight deposits with the RBI?
- (A) Standing Deposit Facility (SDF)
 - (B) Fixed Rate Reverse Repo (FRRR)
 - (C) Marginal Standing Facility (MSF)
 - (D) Long Term Variable Rate Repo (LTR)

Oct/Nov 2008

74. Match the legislative provisions in List I with their corresponding subject matter in List II.

List I: (Legislative Provisions)

- P. Section 42(1) of RBI Act 1934
- Q. Section 18(1) of BR Act 1949
- R. Section 24 of BR Act 1949
- S. Section 56 of BR Act 1949

List II: (Subject Matter)

1. Mandates CRR for Scheduled Commercial Banks
 2. Mandates CRR for non-scheduled/other banks
 3. Prescribes the Statutory Liquidity Ratio (SLR)
 4. Read with Section 24 to envisage penal interest for SLR defaults
- (A) P-1, Q-2, R-3, S-4
 - (B) P-2, Q-3, R-1, S-4
 - (C) P-4, Q-1, R-2, S-3
 - (D) P-3, Q-4, R-1, S-2

May/June 2006

75. Due to sudden customer withdrawals, Bank Zeta is facing a severe intra-day liquidity constraint and its excess SLR holdings are fully depleted. To meet its payment obligations, it decides to draw funds under the Marginal Standing Facility (MSF). Up to what limit can Bank Zeta draw funds under this facility?
- (A) Up to Excess SLR + 2 per cent below SLR
 - (B) Up to 4.50% of its total Net Demand and Time Liabilities

- (C) Up to 90% of its Cash Reserve Ratio requirement
- (D) Unlimited funds provided it pays a 5% penal interest rate

Oct/Nov 2017

76. Match the following institutions/systems in List I with their primary functions in List II.

List I: (Institutions/Systems)

- P. IDRBT
- Q. CCIL
- R. NSDL
- S. SFMS

List II: (Primary Functions)

1. Facilitates domestic transfer of funds and authenticated messages
 2. Settles inter-bank USD/Rupee and cross currency deals on net basis
 3. Provides delivery vs. payment (DVP) for secondary market deals
 4. Developed the Indian Financial Net Work (INFINET)
- (A) P-4, Q-2, R-3, S-1
 - (B) P-2, Q-1, R-4, S-3
 - (C) P-1, Q-3, R-2, S-4
 - (D) P-3, Q-4, R-1, S-2

May/June 2008

77. A primary dealer is executing a trade on the NDS-OM platform and wants to know the identity of the seller before committing. When will the dealer know the counter-party's identity?
- (A) Immediately upon logging into the platform via secure authentication
 - (B) Only after the offered price and volume have been accepted by the system
 - (C) Immediately after the dealer places a counter-bid in the electronic system
 - (D) The identity remains permanently hidden even after settlement by the CCIL

Oct/Nov 2013

78. Match the scenarios in List I with the corresponding penalty or requirement in List II.

List I: (Scenarios)

- P. Daily CRR cash balance requirement
- Q. Default in maintaining daily CRR balance (Day 1)
- R. Continuing shortfall in CRR balance on the succeeding day
- S. Failure to maintain SLR on any day

List II: (Penalty or Requirement)

NODIA

electronic platform simultaneously.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

- 66.** Scheduled Commercial Banks are exempted from maintaining CRR on specific liabilities. Which of the following exemptions is NOT applicable for the computation of SLR?
- (A) Current deposits held by retail customers
 - (B) Time liabilities portion of savings bank deposits
 - (C) Demand and Time Liabilities in respect of Offshore Banking Units (OBUs)
 - (D) Margin held against letters of credit payable on demand

May/June 2017

- 67.** A Scheduled Commercial Bank is required to calculate its Cash Reserve Ratio (CRR) for the reporting Friday ending October 22, 2021. According to the regulatory guidelines on the calculation lag, which Net Demand and Time Liabilities (NDTL) base must the bank utilize?
- (A) The NDTL as at the end of the second preceding fortnight
 - (B) The NDTL as at the end of the reporting fortnight (October 22, 2021)
 - (C) The NDTL as at the end of the first preceding fortnight (October 8, 2021)
 - (D) The average NDTL of the previous calendar month

Oct/Nov 2005

- 68.** Which of the following best describes the primary intention behind RBI impounding reserve money by means of the Cash Reserve Ratio (CRR)?
- (A) To generate interest income for Scheduled Commercial Banks
 - (B) To fund apex financial institutions like NABARD and SIDBI
 - (C) To directly subsidize the District Rural Development Agency
 - (D) To reduce the money multiplier effect and control system liquidity

May/June 2020

- 69.** Following the default on Monday, Bank Alpha continues to face a CRR shortfall of Rs. 50 crores on the next succeeding day (Tuesday). Assuming the Bank Rate remains at 5% p.a., what penal interest rate will the RBI recover for Tuesday's default?
- (A) 5% p.a.
 - (B) 8% p.a.
 - (C) 15% p.a.
 - (D) 10% p.a.

Oct/Nov 2015

- 70.** Why do banks need systems to provide intra-day liquidity (IDL) through automatic repo under the RTGS?
- (A) Because RTGS requires settlements in physical gold by the end of the day
 - (B) Because RTGS transactions are routed exclusively through Offshore Banking Units
 - (C) Because RTGS uses instant gross settlement, requiring continuous funding with RBI
 - (D) Because RTGS batches all transactions to be cleared simultaneously at 11:59 PM

May/June 2013

- 71.** To manage excess liquidity leading to inflation, the RBI reduces the Cash Reserve Ratio (CRR) requirement by 0.5%. What is the direct intended outcome of this action on the money market?
- (A) A withdrawal of approximately Rs. 80-85,000 crore from the system to absorb excess liquidity.
 - (B) An injection of approximately Rs. 80-85,000 crore into the money market to increase supply.
 - (C) An immediate requirement for banks to borrow heavily from the Marginal Standing Facility desk.
 - (D) A mandatory decrease in the Statutory Liquidity Ratio by an equal proportion for all banks.

Oct/Nov 2021

- 72.** Arrange the following events in the correct chronological sequence for the calculation and maintenance of CRR:
- I. The end of the second preceding fortnight
 - II. Collection of relevant information from the branches
 - III. The lag of one fortnight
 - IV. The reporting Friday basis for CRR

ANSWERS

1. (C) Structured Financial Messaging System (SFMS) over the INFINET
The Structured Financial Messaging System is a secure communication protocol used for transmitting domestic financial messages between banks. It operates over the Indian Financial Network, a dedicated communication backbone. This system ensures high security and standardization for inter-bank fund transfers and other financial communications, functioning similarly to international systems like SWIFT but tailored for domestic operations.
2. (C) INFINET : A secure worldwide financial messaging system exclusive to banks
The Indian Financial Network is a closed user group communication network for the Indian banking and financial sector. It is not a worldwide messaging system. While it provides a secure environment for various applications like RTGS and SFMS, its scope is limited to domestic participants within India, unlike SWIFT which facilitates global financial communication across borders.
3. (A) Surplus funds available with banks that have not been absorbed by the real economy
Liquidity in the banking system refers to the surplus funds available with commercial banks after meeting regulatory requirements and credit demands. These funds represent money that has not yet been absorbed by the real economy through lending or investments. Managing this surplus is a primary objective of central bank monetary policy through various market-based instruments.
4. (B) II only
The Reserve Bank of India does not pay interest on the balances maintained by banks to meet the Cash Reserve Ratio requirement. This lack of interest income effectively increases the cost of funds for the banking sector, as these impounded deposits cannot be used for lending or earning returns, thereby acting as a cost to banks.
5. (D) A screen-based system matching orders without revealing participant identity until settled
Anonymous trading is a market mechanism where participants place buy or sell orders on an electronic platform without disclosing their identity to other traders. The system matches orders based on price and time priority. The identities of the parties involved remain hidden until the trade is executed and settled through a centralized clearing corporation.
6. (A) I only
The Negotiated Dealing System - Order Matching facilitates straight-through processing where executed trades flow directly to the Clearing Corporation of India for settlement. It eliminates the need for physical cheques or written confirmations. This electronic environment enhances efficiency and transparency in government securities trading, allowing for seamless settlement without the traditional manual paperwork or physical delivery.
7. (C) Rs. 5 crore
Under the Liquidity Adjustment Facility framework, banks must adhere to specific bidding requirements for repo transactions. The minimum bid amount is set at five crore rupees. Any bids submitted must be for this minimum amount or in multiples thereof. This ensures that the facility is utilized for significant liquidity management rather than small, frequent retail-level transactions.
8. (B) II and III only
Statutory Liquidity Ratio maintenance involves holding assets like cash, gold, and approved securities. However, the cash balances maintained for the Cash Reserve Ratio are generally excluded from SLR computations. Gold must be valued at prices not exceeding market rates, and securities must be approved by the regulator. These assets ensure banks maintain a specific level of liquid reserves.

- 27.** (A) Controlling the rate of inflation and ensuring stability of financial markets

The primary goals of central bank monetary policy are to maintain price stability and ensure the efficient functioning of financial markets. By controlling inflation, the regulator protects the purchasing power of the currency. Simultaneously, monitoring system liquidity and interest rates ensures that financial markets remain stable and can support sustainable economic growth without excessive volatility or systemic risks.

- 28.** (C) 8% p.a.

When a bank fails to maintain the required daily Cash Reserve Ratio balance, the regulator imposes a penal interest rate for the day of default. This penalty is calculated as three percent above the prevailing bank rate. If the bank rate is five percent, the total penal interest applied to the shortfall amount for that first day will be eight percent.

- 29.** (B) LAF monitors daily liquidity, whereas CRR/SLR influence long-term policy stance.

The Liquidity Adjustment Facility is a dynamic tool used to manage day-to-day liquidity fluctuations in the banking system through repo and reverse repo operations. In contrast, reserve requirements like the Cash Reserve Ratio and Statutory Liquidity Ratio are used to influence the long-term monetary policy stance and ensure that banks maintain a baseline level of liquid assets and reserves.

- 30.** (C) No, because the bank is allowed a daily minimum threshold of 90%.

Scheduled Commercial Banks are required to maintain a certain average Cash Reserve Ratio over a fortnight. However, on any given day within that period, they are permitted a degree of flexibility. As long as the daily balance does not fall below ninety percent of the required average, the bank will not attract a penalty for that specific day's shortfall.

- 31.** (D) A specialized body for clearing securities, repo trades, and TREPS

The Clearing Corporation of India is a specialized institution that provides clearing and settlement services for various financial market segments. It handles transactions involving government

securities, money market instruments like repo trades, and the Triparty Repo Dealing and Settlement System. By acting as a central counterparty, it reduces settlement risk and enhances the overall efficiency of the Indian financial markets.

- 32.** (D) The bid will be rejected as it must be in multiples of Rs. 5 crore.

According to the guidelines for the Liquidity Adjustment Facility, repo bids submitted by banks must meet specific structural requirements. The minimum bid amount is five crore rupees, and all bids must be placed in multiples of five crore rupees. A bid for twelve crore rupees does not satisfy this multiple requirement and will therefore be rejected by the system.

- 33.** (B) II, I, IV, III

The evolution of financial infrastructure began with the Negotiated Dealing System in 2002, followed by the Real Time Gross Settlement system in 2004. Later, the order-matching version of NDS was launched in 2005 to improve transparency. The most recent addition is the Standing Deposit Facility, which was introduced in 2022 to enhance the central bank's liquidity management capabilities.

- 34.** (C) The bid will be rejected as banks must quote at or above the Repo Rate.

In the Variable Rate Repo window, participants are required to submit bids that are competitive and align with the central bank's policy rate. Specifically, the rules mandate that any quote provided by a bank must be at or above the prevailing repo rate. Bids that fall below this benchmark are considered invalid and are rejected by the bidding platform automatically.

- 35.** (A) P-2, Q-3, R-1, S-4

The liquidity adjustment framework comprises various tools with specific operational timings. The fourteen-day variable-rate repo is conducted on reporting Fridays. Other term repos are discretionary based on liquidity conditions. The fixed rate reverse repo traditionally operates daily, while the marginal standing facility provides a window for overnight borrowing during late evening hours, including weekends and public holidays.

is generally fixed based on the total net demand and time liabilities of the banking system. Banks must quote rates at or above the repo rate to access funds, while the highest yield quotes are prioritized for fund allocation.

19. (A) The SDF replaced the Marginal Standing Facility as the maximum rate for overnight borrowing
The Standing Deposit Facility was introduced to replace the fixed rate reverse repo as the floor of the liquidity adjustment facility corridor. It does not replace the Marginal Standing Facility, which remains the upper bound of the corridor. All eligible participants can use the facility to place overnight deposits, and it became effective in early April 2022.
20. (A) I, II, IV and V only
Bank treasuries are primarily responsible for ensuring compliance with reserve requirements. Shortfalls in these reserves lead to significant penalties and reputational risks. While adjustments in reserve ratios directly impact market liquidity by injecting or withdrawing billions of rupees, the regulator does not pay interest on the deposits maintained by banks to meet the mandatory Cash Reserve Ratio.
21. (D) Reporting to RBI is done daily via the Structured Financial Messaging System instead of Form A.
Banks are required to report their reserve maintenance status through a fortnightly return known as Form A. This submission provides the regulator with detailed information regarding the bank's liabilities and the reserves held. It is not conducted daily via messaging systems. Failure to maintain these required levels results in penalties, making accurate reporting a critical treasury back-office function.
22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The Cash Reserve Ratio is a regulatory tool that impounds a portion of bank deposits, preventing them from being lent out. This directly restricts the ability of the banking system to create new deposits through multiple rounds of lending. By controlling this money multiplier effect, the

central bank can effectively manage the total money supply and inflationary pressures.

23. (B) Outstanding Telegraphic Transfers (TTs) and Mail Transfers (MTs)
Time liabilities include financial obligations that are payable after a specific period, such as cash certificates and recurring deposits. Staff security deposits also fall into this category. Conversely, outstanding telegraphic and mail transfers are considered demand liabilities because they represent funds that must be paid out immediately upon request or presentation, rather than held for a fixed term.
24. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Participants in the Real Time Gross Settlement system must ensure their accounts are sufficiently funded to cover individual transactions as they occur. To assist with liquidity management during the day, the regulator offers intra-day liquidity facilities. This is achieved through automatic repo transactions using pledged securities, ensuring that the gross settlement process remains smooth and avoids transaction delays.
25. (A) Balances maintained for CRR
The Statutory Liquidity Ratio requires banks to maintain a certain percentage of their liabilities in liquid assets. These assets include cash on hand, gold valued at market prices, and approved government securities. However, the cash balances specifically held to satisfy the separate Cash Reserve Ratio requirement cannot be counted toward the fulfillment of the bank's statutory liquidity ratio obligations.
26. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The monetary policy aims to keep the weighted average call rate closely aligned with the repo rate. By narrowing the corridor formed by the marginal standing facility and the standing deposit facility, the central bank reduces volatility in short-term interest rates. This fine-tuning ensures that market rates reflect the intended policy stance more accurately and promotes financial stability.

1. Penal interest of 5% p.a. above the Bank Rate
 2. Penal interest of 3% p.a. above the Bank Rate
 3. Penal interest as envisaged under Section 24 read with Section 56 of the BR Act, 1949
 4. Not falling below 90% of the required amount
- (A) P-4, Q-2, R-1, S-3
(B) P-2, Q-4, R-3, S-1
(C) P-1, Q-3, R-2, S-4
(D) P-3, Q-1, R-4, S-2

May/June 2015

79. Bank Omega operates an Offshore Banking Unit (OBU) in India for overseas customers. When calculating its Demand and Time Liabilities, how should the liabilities of this OBU be treated?
- (A) They are completely excluded from both CRR and SLR requirements.
(B) They are included in CRR but exempted from SLR requirements.
(C) They attract double the standard CRR rate due to foreign exchange risk.
(D) They are exempted from CRR but not exempted for the computation of SLR.

Oct/Nov 2012

80. Identify the correct pair regarding the limits and conditions of the LAF framework instruments.
- (A) Minimum bid for Repo transactions : Rs. 2 lakhs
(B) Tenor for Long Term Variable Rate Repo (LTR) : Exactly 7 days
(C) Limit for Variable Rate Term Repos : 4.50% of NDTL of the banking system
(D) Marginal Standing Facility (MSF) withdrawal limit : Up to Excess SLR + 2 per cent below SLR

- 36.** (D) The minimum amount for customer remittances under RTGS is Rs. 2 lakhs. Real Time Gross Settlement is intended for large-value transactions that require immediate and individual processing. For customer remittances, the regulator has established a minimum threshold of two lakh rupees per transaction. Requests for electronic transfers below this amount cannot be processed through this system and must instead be handled by other payment mechanisms like the National Electronic Funds Transfer.
- 37.** (A) P-3, Q-4, R-1, S-2
The Asian Currency Unit is a regional payment arrangement, while Offshore Banking Units provide specialized services to overseas clients from domestic locations. SWIFT acts as the primary global messaging network for financial institutions worldwide. Depositories are essential infrastructure components that hold and manage securities in an electronic format, facilitating seamless transfers and reducing the risks associated with physical certificates.
- 38.** (C) The Clearing Corporation of India Ltd. (CCIL) via the FX Clear system
Foreign exchange transactions involving the dollar and rupee are processed through a dedicated electronic platform known as FX Clear. Managed by the Clearing Corporation of India, this system provides straight-through processing and facilitates the net settlement of deals. This centralized approach significantly reduces counterparty risk and improves the overall efficiency and transparency of the foreign exchange market in India.
- 39.** (B) Money Multiplier : $M3 \text{ divided by Reserve Money } (M0)$
The money multiplier is a critical economic ratio that illustrates the relationship between the total money supply and the reserve money created by the central bank. It is calculated by dividing Broad Money, denoted as M3, by Reserve Money, denoted as M0. This ratio reflects the extent to which the banking system generates additional money through the process of relending.
- 40.** (A) Time Liabilities
When a bank holds margin money against a letter of credit that is not payable on demand, it must classify these funds as time liabilities. This classification is used when calculating the net demand and time liabilities for reserve requirements. Unlike demand liabilities which are payable immediately, these funds are held by the bank for a specified period or purpose.
- 41.** (A) Credit balances in ACU (US\$) Accounts : Included in the CRR stipulation
Certain financial liabilities are exempted from the calculation of the Cash Reserve Ratio. Credit balances in Asian Currency Unit dollar accounts are among these exemptions for scheduled commercial banks. Other exclusions include the bank's own capital, reserves, and claims received from insurance corporations. Misclassifying these exempt items as included liabilities would result in an overestimation of the required reserve balance.
- 42.** (B) Money Multiplier Effect
The process where initial deposits in the banking system lead to a series of loans and new deposits is known as the money multiplier effect. Each round of lending increases the total money supply within the economy. Central banks use reserve requirements to control this process, as higher reserves limit the amount banks can lend, thereby reducing the multiplier effect.
- 43.** (A) I only
Scheduled Commercial Banks are required to maintain a daily minimum of ninety percent of their mandated Cash Reserve Ratio. This flexibility allows for minor fluctuations in liquidity throughout the reporting fortnight. However, this specific ninety percent daily minimum threshold is not applied to all types of financial institutions, such as Urban Cooperative Banks, which may follow different regulatory maintenance standards.
- 44.** (C) RBI lending funds to the banking sector through the Repo instrument and accepting surplus funds under Reverse Repo
The Liquidity Adjustment Facility is a primary tool used by the central bank to manage short-term liquidity in the economy. It allows banks to borrow funds through repo transactions when they face shortages or deposit surplus funds with the regulator through reverse repo operations. This mechanism helps in stabilizing short-term

interest rates and ensuring adequate liquidity in the banking system.

45. (A) I only

In a repo transaction, the central bank buys government securities from commercial banks with a formal agreement to sell them back at a later date. While the ownership of these securities is transferred electronically, no physical movement of paper certificates or cheques occurs. This electronic process ensures rapid settlement and efficiency in managing the liquidity needs of the banking sector.

46. (C) 25%

Money supply aggregates are categorized based on their liquidity, with M1 being the most liquid and M3 being the broadest measure. For the fiscal period of 2020-21, the most liquid components of the money supply accounted for approximately twenty-five percent of the total broad money. This distribution highlights the significant role that time deposits play in the overall money supply.

47. (D) I, II and III

The regulator provides specific exemptions for certain types of liabilities when banks calculate their Cash Reserve Ratio. These exemptions include income tax provisions, liabilities related to offshore banking units, and various subsidies received from development agencies like NABARD. These exclusions ensure that the reserve requirement is applied to the core deposit base of the bank rather than temporary or specialized funds.

48. (C) October 2004

The Real Time Gross Settlement system was fully activated by the central bank in March 2004. This implementation marked a significant milestone in the modernization of India's payment infrastructure. By providing a platform for instantaneous and final settlement of large-value transactions, it greatly reduced systemic risks and improved the efficiency of funds transfer within the domestic banking and financial sectors.

49. (A) I and II only

Long Term Variable Rate Repos are designed to provide liquidity to the banking system for periods exceeding fourteen days. The total amount offered in these auctions is determined by

the central bank based on its current assessment of liquidity needs. These operations are not conducted daily or during late evening hours, distinguishing them from overnight facilities used for immediate liquidity adjustments.

50. (C) A utility service to replenish physical currency stocks for the convenience of the public

As financial systems evolve and the money multiplier effect becomes more prominent, the relative importance of physical currency in the total money supply decreases. In this context, the central bank's role in issuing banknotes transforms into a utility service. Its primary purpose becomes the replenishment of physical cash to meet public demand and ensure the smooth circulation of tangible currency.

51. (D) I, II and III

The Asian Currency Unit is a regional mechanism that facilitates payments between member nations like India, Nepal, and Sri Lanka. Transactions are handled through dedicated dollar accounts with correspondent banks. Furthermore, the credit balances held in these specific accounts are exempted from the Cash Reserve Ratio requirement for scheduled commercial banks, providing a regulatory incentive for participating in this regional settlement system.

52. (D) By ensuring funds and securities transfers occur on the electronic platform simultaneously

The Delivery versus Payment system is a settlement method that ensures the transfer of securities only happens if the corresponding payment is made. By linking these two actions simultaneously on an electronic platform, the system eliminates settlement risk. This means neither party is exposed to the danger of delivering an asset without receiving payment or paying for an asset not delivered.

53. (A) I, II and III only

The Standing Deposit Facility was launched in April 2022 to absorb surplus liquidity without requiring collateral. It replaced the fixed rate reverse repo as the floor of the liquidity adjustment facility corridor. While it provides an overnight deposit option for all eligible participants, it does not serve as the upper bound of the corridor, which is occupied by the MSF.

- 54.** (C) An amendment to the RBI Act in 2006 removed the floor and ceiling limits, enabling RBI discretion.
Significant legislative changes in 2006 amended the Reserve Bank of India Act to give the regulator more autonomy. Specifically, the amendment removed the previously fixed floor and ceiling limits for the Cash Reserve Ratio. This allows the central bank the discretion to set the ratio at any level necessary to effectively manage system liquidity and achieve its monetary policy objectives.
- 55.** (C) I, II and IV only
NDS-OM is an electronic, order-driven platform for trading government securities where matching occurs based on price and time priority. It maintains participant anonymity until the trade is finalized. The system supports straight-through processing by sending trades directly for settlement. While highly efficient, it did not completely eliminate the older telephone-based trading methods, as both mechanisms continue to coexist in the market.
- 56.** (A) A forex system by CCIL providing straight-through processing for USD/INR deals on a net basis
FX Clear is an electronic trading platform managed by the Clearing Corporation of India for foreign exchange deals. It specifically handles transactions involving the US dollar and the Indian rupee. The system facilitates straight-through processing and ensures that these deals are settled on a net basis. This centralized clearing process enhances market stability and reduces the risks associated with bilateral settlements.
- 57.** (A) I, II, IV and V only
For regulatory reporting, unclaimed deposits are treated as demand liabilities, while gold deposits are classified as time liabilities. Conversely, staff security deposits are generally categorized as time liabilities. Specific items like rediscounted bills and certain developmental subsidies are excluded from the Cash Reserve Ratio requirement. Accurate classification is essential for banks to comply with reserve maintenance and reporting standards.
- 58.** (B) Credit balances in ACU (US\$) Accounts are included in the CRR stipulation.
In the framework for calculating reserve requirements, specific liabilities are granted exemptions. While items like paid-up capital, income tax provisions, and insurance claims are excluded, credit balances in Asian Currency Unit dollar accounts are also exempted for scheduled commercial banks. Claiming these are included in the Cash Reserve Ratio stipulation is incorrect according to the current regulatory guidelines for bank reporting.
- 59.** (A) I, II, III and IV only
The infrastructure for financial settlements has evolved significantly with the introduction of electronic systems for reporting government securities and gross settlement of payments. Secure communication backbones developed by specialized institutes support these functions. Today, paper-based checks and manual confirmations are no longer mandatory for settlements through the clearing corporation, as electronic processes have become the standard for speed and security.
- 60.** (C) Counter-party identity is disclosed to all participants prior to price acceptance.
The Negotiated Dealing System - Order Matching is designed as an anonymous platform. In this system, the identities of the buyers and sellers are not revealed to the participants during the bidding or matching process. Disclosure only occurs after the trade has been accepted by the system for settlement. This anonymity is a key feature that promotes fair and unbiased trading.
- 61.** (A) I, II, III and V only
Settlement in financial markets involves the simultaneous exchange of funds and assets. Depositories facilitate this through electronic systems that eliminate traditional settlement risks. Specialized banking units also provide services to overseas clients using isolated accounting. While the regulator oversees these systems, it is the primary legislative framework that establishes the core mandates for payment and settlement regulation and supervision.
- 62.** (C) Gold deposits
Demand liabilities consist of funds that a bank must pay out immediately upon request,

- 80.** (D) Marginal Standing Facility (MSF) withdrawal limit : Up to Excess SLR + 2 per cent below SLR
The liquidity adjustment framework includes various instruments with specific operational limits. Repo transactions require a minimum bid of five crore rupees. Long-term repos have tenors exceeding fourteen days. Additionally, the marginal standing facility allows banks to borrow funds against their statutory liquidity ratio securities, with the borrowing limit determined by the amount of excess and required securities they hold.

were previously impounded. A reduction of half a percentage point currently results in a significant injection of liquidity, approximately eighty to eighty-five thousand crore rupees, into the money market. This action increases the supply of money available for lending, thereby supporting economic activity and managing liquidity conditions.

72. (A) I, II, III, IV

Maintaining the Cash Reserve Ratio begins with identifying the liability base from the end of the second preceding fortnight. Banks then collect the necessary financial data from their branch network. This process involves a standard one-fortnight lag before the final figures are used to determine the required reserve balance for the current reporting Friday and the subsequent maintenance period.

73. (A) Standing Deposit Facility (SDF)

Following the updates to the liquidity adjustment framework in April 2022, the Standing Deposit Facility became the primary tool for absorbing surplus system liquidity. Banks with excess funds at the end of the day can place these as overnight deposits with the central bank. This facility operates without the need for collateral, providing a modern and efficient floor for interest rates.

74. (A) P-1, Q-2, R-3, S-4

Different sections of banking laws govern reserve requirements for various types of banks. One section mandates reserves for scheduled commercial banks, while another covers non-scheduled institutions. Furthermore, specific legislation prescribes the statutory liquidity ratio and details the penalties for defaults. Understanding these distinct legal provisions is essential for ensuring regulatory compliance and avoiding the associated financial penalties.

75. (A) Up to Excess SLR + 2 per cent below SLR

The Marginal Standing Facility provides a safety valve for banks facing acute liquidity shortages. Under this facility, banks can borrow funds overnight from the central bank. The borrowing limit is tied to their statutory liquidity ratio holdings, allowing them to draw funds up to the amount of their excess holdings plus a specified

percentage of the required statutory liquidity ratio.

76. (A) P-4, Q-2, R-3, S-1

Specialized institutes provide the communication infrastructure, while the clearing corporation handles the net settlement of foreign exchange and money market deals. Depositories ensure safe and simultaneous transfer of securities and funds. Additionally, dedicated messaging systems facilitate the secure transfer of financial information and domestic funds. Together, these entities form the backbone of the modern electronic payment and settlement ecosystem.

77. (B) Only after the offered price and volume have been accepted by the system

The NDS-OM platform operates on the principle of anonymity to ensure market neutrality and efficiency. Participants entering bids or offers do not know who the other side is during the negotiation phase. The system only reveals the identity of the counter-party after the trade has been successfully matched and accepted for processing by the clearing and settlement corporation.

78. (A) P-4, Q-2, R-1, S-3

Banks must maintain a daily minimum of ninety percent of their required reserve balance. Falling below this threshold triggers a penal interest of three percent above the bank rate on the first day. If the shortfall continues, the penalty increases to five percent above the bank rate. Penalties for failing to maintain statutory liquidity levels are governed by specific banking regulations.

79. (D) They are exempted from CRR but not exempted for the computation of SLR.

Offshore Banking Units are specialized domestic offices that cater to overseas customers. For regulatory purposes, the liabilities of these units are treated differently than standard domestic deposits. While they are exempted from the Cash Reserve Ratio requirement to promote international competitiveness, they are not exempt from the Statutory Liquidity Ratio. Therefore, they must be included in the SLR computation base.

independent oversight, the Mid Office should ideally report directly to whom?

- (A) The Chief Dealer in charge of the trading desk.
- (B) A senior executive independent of Treasury operations.
- (C) The Treasury Head responsible for front office activities.
- (D) The Operations Head overseeing the back office settlement.

Oct/Nov 2011

23. Prime Bank calculates its VaR by analyzing the standard deviation of USD/INR exchange rates from their mean over an observed period, relying on volatility and assuming a normal distribution curve. This specific methodology is identified in risk management as:
- (A) Monte Carlo Simulation
 - (B) Historical Data Approach
 - (C) Back-testing Approach
 - (D) Parametric Approach

May/June 2010

24. To extrapolate the overnight Value at Risk (VaR) for a longer period (n days), the overnight VaR is mathematically multiplied by which of the following factors?
- (A) n squared
 - (B) The absolute value of n
 - (C) The natural logarithm of n
 - (D) The square root of n

Oct/Nov 2024

25. How is 'Cost of Carry' formally defined in the context of treasury trading operations?
- (A) The cost incurred in executing continuous linked settlements across time zones.
 - (B) The interest cost of funds locked in a trading position.
 - (C) The penalty paid to RBI for exceeding overnight open position limits.
 - (D) The difference between aggregate assets and aggregate liabilities.

May/June 2017

26. In Global Bank's Treasury, Ms. Y is responsible for independently confirming swap deals directly with counterparty banks and ensuring the deals fall within approved exposure limits. Based on the organizational controls, Ms. Y functions within which operational division?

- (A) Front office
- (B) Mid office
- (C) ALM support group
- (D) Back office

Oct/Nov 2005

27. Why are overnight open position limits generally kept smaller compared to daylight open position limits in foreign exchange trading?
- (A) The market stays active at night while domestic dealers are not available to track price movements.
 - (B) The foreign exchange market closes globally during the night, effectively eliminating all potential price movements.
 - (C) Capital adequacy requirements for overnight positions are exclusively monitored and reported by the Front Office.
 - (D) Overnight transactions strictly involve merchant deals rather than trade deals executed in the inter-bank market.

May/June 2020

28. Prime Bank's Mid office calculates the overnight Value at Risk (VaR) for its USD/INR trading portfolio at 45 paise, assuming a 95% confidence level. Today's spot rate for USD/INR is Rs. 75.00. Under normal market conditions, what is the worst possible rate the bank can assume for USD/INR exports tomorrow?
- (A) Rs. 75.45
 - (B) Rs. 74.55
 - (C) Rs. 75.00
 - (D) Rs. 75.95

Oct/Nov 2021

29. What is the capital requirement percentage prescribed by RBI to be maintained on the higher of the Net Overnight Open Position Limit (NOOPL) or the outstanding position as on the Balance Sheet Date?
- (A) 5%
 - (B) 6%
 - (C) 8%
 - (D) 9%

May/June 2013

30. Beta Bank's treasury holds a 5-year coupon-bearing bond yielding 6%. The manager wants to calculate the exact likely percentage change in the price of this bond if the market yield suddenly changes. Which specific mathematical

CHAPTER 23

Treasury Risk Management

NOPIA

Oct/Nov 2015

1. Horizon Bank lends heavily in the inter-bank money market. Suddenly, a borrowing counterparty bank faces a run on its deposits and goes bankrupt, failing to repay the loan amount on the due date. This scenario illustrates which specific type of risk faced by Horizon Bank?
 - (A) Settlement risk
 - (B) Interest rate risk
 - (C) Systematic risk
 - (D) Default risk

May/June 2023

2. What is the precise definition of 'Volatility' in the context of financial markets?
 - (A) The guaranteed rate of return at which the present value of future cash flows equals the current market price of a security.
 - (B) The maximum possible loss that may take place within a specific time horizon under normal and expected trading circumstances.
 - (C) The degree of fluctuation in variables like interest and exchange rates, measured as standard deviation from the mean.
 - (D) The inverse proportion between the market yield and the traded price of a government bond or other fixed-income instrument.

Oct/Nov 2009

3. Bank Alpha's Chief Dealer holds a losing currency position. Hoping the market will turn around, the dealer waits, but losses quickly accumulate beyond the acceptable management threshold of USD 10,000. To prevent the dealer from waiting indefinitely, which control measure must be immediately enforced?
 - (A) Deal size limit
 - (B) Aggregate gap limit
 - (C) Stop-loss limit
 - (D) Counterparty exposure ceiling

May/June 2016

4. Beta Bank's treasury relies on a crucial mathematical assumption regarding

intermittent cash flows when calculating Yield to Maturity. What is this underlying assumption?

- (A) All intermittent cash flows are consumed immediately upon receipt.
- (B) All intermittent cash flows are reinvested at the continuously changing daily market rate.
- (C) All intermittent cash flows are reinvested at the uniform discount rate of the bond.
- (D) All intermittent cash flows are stored as zero-yielding cash reserves.

Oct/Nov 2018

5. Prime Bank determines that its overnight Value at Risk (VaR) for a specific bond portfolio is Rs. 10 lakhs. The bank's risk committee wants to estimate the potential loss over a 16-day period using the standard VaR scaling formula. What is the approximate 16-day VaR for this portfolio?
 - (A) Rs. 160 lakhs
 - (B) Rs. 40 lakhs
 - (C) Rs. 16 lakhs
 - (D) Rs. 2.5 lakhs

May/June 2007

6. Regarding the measurement of risk in forward positions, which of the following statements is correct?
 - (A) The risk is eliminated entirely because purchase and sale prices are prefixed.
 - (B) The risk is measured by 'gaps' representing residual time for completion, which are capped with a gap limit.
 - (C) The risk is controlled strictly by applying a 5% broker exposure limit.
 - (D) The risk is non-existent unless the transaction is mapped to a zero-coupon bond.

Oct/Nov 2025

7. Bank Alpha's Treasury executes USD 5 million foreign exchange transactions despite having a very low funding requirement. The transactions rely on margin rather than full capital

including unclaimed deposits, credit balances in cash credit accounts, and overdue fixed deposits. Gold deposits, however, are specifically classified as time liabilities for regulatory purposes. This distinction is vital when banks calculate their net demand and time liabilities for the maintenance of required reserves.

- 63.** (C) Assertion (A) is true, but Reason (R) is false. The central bank utilizes the repo rate as a benchmark to signal its monetary policy stance. By adjusting the boundaries of the policy rate corridor, it indirectly influences market interest rates. This method provides the regulator with significant flexibility to manage liquidity and respond to economic changes, rather than resorting to the direct and rigid fixing of short-term interest rates.
- 64.** (D) Demand liabilities portion of savings bank deposits
While the regulator excludes several items from the Cash Reserve Ratio calculation, such as refinance from apex institutions and specific subsidies, the core deposit base is not exempted. Specifically, the portion of savings bank deposits classified as demand liabilities must be included in the net demand and time liabilities computation. This ensures that the primary deposits of the public are reserved.
- 65.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Institutions like the National Securities Depository Limited use the Delivery versus Payment mechanism to handle secondary market transactions. This system ensures that the transfer of securities and the corresponding payment occur at the same time on an electronic platform. By synchronizing these two events, the possibility of one party defaulting after the other has performed is effectively eliminated.
- 66.** (C) Demand and Time Liabilities in respect of Offshore Banking Units (OBUs)
Certain liabilities are exempt from the Cash Reserve Ratio but not from the Statutory Liquidity Ratio. For instance, while liabilities of Offshore Banking Units are exempted from CRR maintenance to encourage international banking, they must still be included when calculating the

SLR requirement. This ensures that these units maintain a baseline level of liquidity despite their specialized regulatory status.

- 67.** (A) The NDTL as at the end of the second preceding fortnight
To calculate the required Cash Reserve Ratio for a specific reporting fortnight, banks use a predefined historical base. Specifically, they must utilize the net demand and time liabilities as they stood at the end of the second preceding fortnight. This calculation lag provides banks with the necessary time to gather data and adjust their reserves to meet the regulatory requirements.
- 68.** (D) To reduce the money multiplier effect and control system liquidity
The fundamental reason for the central bank to impound reserves through the Cash Reserve Ratio is to manage the overall money supply. By removing a portion of cash from the banking system, the regulator limits the banks' ability to create credit through repeated lending. This reduction in the money multiplier effect is a key tool for controlling inflation and system liquidity.
- 69.** (D) 10% p.a.
If a bank's failure to maintain the required Cash Reserve Ratio balance continues into a second day, the penalty increases. The regulator applies a penal interest rate of five percent above the bank rate for any succeeding days of default. Given a bank rate of five percent, the total penal interest for the second day of the shortfall is ten percent.
- 70.** (C) Because RTGS uses instant gross settlement, requiring continuous funding with RBI
The Real Time Gross Settlement system requires that each transaction is settled individually and immediately. This continuous settlement process throughout the day necessitates that banks maintain sufficient funds in their accounts with the central bank. To prevent delays caused by temporary cash flow mismatches, the regulator provides intra-day liquidity, often through automatic repos, to ensure the system functions smoothly.
- 71.** (B) An injection of approximately Rs. 80-85,000 crore into the money market to increase supply.
When the regulator reduces the Cash Reserve Ratio requirement, it releases funds that

- (D) Cannot be determined without the yield curve

Oct/Nov 2022

15. How does the actual term structure of interest rates fundamentally limit the unadjusted application of Modified Duration?
- (A) Short-term and long-term interest rates always increase or decrease in an exact fixed proportion, rendering Modified Duration useless.
- (B) Modified Duration only works for equity markets, not fixed-income securities.
- (C) Modified Duration accounts for default risk but ignores market risk entirely.
- (D) The yield curve is rarely a straight line, and rates change at varying speeds, necessitating a convexity adjustment for greater accuracy.

May/June 2018

16. Bank Alpha's Chief Dealer purchases USD 1 million in the morning, intending to sell it in the afternoon to capture intraday price movements. This specific morning purchase, pending an afternoon sale, represents which type of trading position subject to internal management limits?
- (A) Daylight open position
- (B) Aggregate gap position
- (C) Forward rate mismatch
- (D) Overnight open position

Oct/Nov 2016

17. In treasury operations, why is the risk of losing capital considered much higher compared to the traditional credit business?
- (A) High leverage allows massive exposure with a very low initial capital or funding requirement.
- (B) Treasury operations always use tangible assets as collateral for all money market and inter-bank borrowings.
- (C) Treasury departments completely avoid taking open positions in foreign exchange to eliminate market volatility.
- (D) Treasury lending activities are severely restricted by the volume of customer deposits held by the institution.

May/June 2014

18. Horizon Bank executes a massive USD/INR foreign exchange transaction. Due to different time zones between India and New York, there

is an unavoidable time gap between the INR settlement and the USD settlement, raising the possibility that the counterparty might fail to complete their leg. This vulnerability is technically termed as:

- (A) Settlement risk
- (B) Funding risk
- (C) Mismatch risk
- (D) Price risk

Oct/Nov 2007

19. Aggregate Gap Limit (AGL) for forward positions in the forex market is internally approved by the management. This limit is capped by regulatory standards at what multiple of a Bank's Capital?
- (A) 2 times
- (B) 4 times
- (C) 6 times
- (D) 9 times

May/June 2025

20. Beta Bank's portfolio contains a government bond with a calculated Modified Duration of 2.38. If the yield on this bond rises by exactly 5 basis points (0.05%), what will be the corresponding approximate percentage change in the price of the bond?
- (A) A rise of 12 basis points
- (B) A fall of 12 basis points
- (C) A rise of 2.38 percent
- (D) A fall of 2.38 percent

Oct/Nov 2019

21. Which of the following statements accurately reflects the relationship between yield and the price of a bond?
- (A) Yield and price of a bond move in direct proportion to each other.
- (B) Yield and price of a bond move independently based on equity market trends.
- (C) Yield and price of a bond move in inverse proportion to each other.
- (D) Yield and price of a bond remain static until the maturity date is reached.

May/June 2009

22. Global Bank's management is restructuring its reporting lines to ensure optimal risk control. The Front Office reports to the Treasury Head, and the Back Office reports to the Operations Head. To maintain total segregation and

NODIA

deployment, allowing the bank to capture market opportunities without massive resource allocation. Based on this scenario, which concept best describes this operational ability of Bank Alpha's Treasury?

- (A) Mark-to-Market Valuation
- (B) Leverage
- (C) Macro-hedging
- (D) Speculation

May/June 2012

8. What is the formal definition of 'Market Risk' as provided by the Bank for International Settlements (BIS)?

- (A) The risk that counterparty banks fail to deliver their side of a transaction due to operational or financial failures.
- (B) The risk that movements in equity, interest, currency, and commodity markets will adversely affect position values.
- (C) The risk of losing principal amounts invested in lending operations due to the insolvency or default of corporate entities.
- (D) The risk that cash flow gaps cannot be bridged because of a lack of depth or liquidity in the inter-bank money market.

Oct/Nov 2014

9. To avoid business concentration, the Reserve Bank of India imposes a ceiling on the total business in a year that a bank can conduct through an individual foreign exchange and money market broker. What is this ceiling limit?
- (A) 2%
 - (B) 5%
 - (C) 9%
 - (D) 10%

May/June 2019

10. To mitigate the risk of a counterparty defaulting during the time gap between currency settlements across different time zones, Horizon Bank decides to utilize a centralized institutional mechanism. Which mechanism specifically addresses this issue by ensuring Payment versus Payment (PvP)?
- (A) Securities General Ledger (SGL)
 - (B) Clearing Corporation of India Ltd (CCIL)
 - (C) Continuous Linked Settlements (CLS)
 - (D) Real Time Gross Settlements (RTGS)

Oct/Nov 2006

11. Which of the following statements correctly describes a primary function of the back office in treasury operations?
- (A) It solely executes deals with counterparty banks and manages the trading book.
 - (B) It provides inputs to ALM and formulates the bank's overall risk management policies.
 - (C) It conducts cross-currency trades directly on the Reuters/Bloomberg terminals.
 - (D) It obtains independent confirmation of deals and is responsible for their settlement.

May/June 2021

12. In Global Bank's Treasury, Mr. Z is tasked with the daily mark-to-market (MTM) valuation of trading positions, verification of derivative pricing, and monitoring compliance with ALM guidelines. According to standard treasury structure, Mr. Z operates in which office?
- (A) Front office
 - (B) Back office
 - (C) Mid office
 - (D) Trading book desk

Oct/Nov 2010

13. Which of the following best defines 'Mismatch' in treasury risk management?
- (A) Differences in duration of assets and liabilities, or sources and uses of funds with varying payment terms and maturities.
 - (B) The variation between the purchase price of a fixed-income security and its final redemption value at the date of maturity.
 - (C) The discrepancy between front office deal slips and the back office independent confirmations regarding transaction details.
 - (D) The statistical difference between actual market movements and results generated by Monte Carlo Value at Risk simulations.

May/June 2005

14. Beta Bank's treasury holds a zero-coupon government bond with exactly 3 years remaining until maturity. The portfolio manager is evaluating the interest rate risk of this bond compared to coupon-bearing bonds. According to duration principles, what is the Macaulay duration of this zero-coupon bond?
- (A) Less than 3 years
 - (B) Exactly 3 years
 - (C) More than 3 years

measure must the manager use to arrive at this direct price sensitivity?

- (A) Yield to Maturity (YTM)
- (B) Macaulay Duration
- (C) Volatility Index
- (D) Modified Duration

Oct/Nov 2015

31. Treasury faces multiple risks and uses various control limits. Which of the following is NOT classified as an internal control limit imposed directly on the trading dealers?

- (A) Limits on deal size
- (B) Limits on open positions
- (C) Counterparty exposure ceiling limits
- (D) Stop-loss limits

May/June 2024

32. Match the Value at Risk (VaR) approaches and concepts in List I with their key characteristics in List II.

List I: (Approaches)

- P. Parametric Approach
- Q. Monte Carlo Simulation
- R. Historical Data Approach
- S. Back-testing

List II: (Characteristics)

- 1. Uses time series of data prevailing over a past period.
- 2. Generates a number of random scenarios to study impact.
- 3. Relies on variance, co-variance, standard deviation, and a normal distribution curve.
- 4. Tests the appropriateness and accuracy of the utilized VaR Model.

- (A) P-1, Q-3, R-4, S-2
- (B) P-3, Q-2, R-1, S-4
- (C) P-2, Q-4, R-3, S-1
- (D) P-4, Q-1, R-2, S-3

Oct/Nov 2008

33. Identify the incorrect statement concerning stop-loss limits in treasury trading.

- (A) Stop-loss limits represent the final stage of controlling trading operations when the market moves adversely.
- (B) They allow dealers to wait indefinitely for a market turnaround to close the position with a profit.
- (C) They are prescribed per deal, per day, per month, as well as an aggregate loss limit per year.

- (D) Any violation of the stop-loss limit by continuing to hold the losing position is viewed seriously by management.

May/June 2006

34. Which of the following pairs of risk limits and their corresponding characteristics is incorrectly matched?

- (A) Overnight open position limit – Requires pre-approval from regulatory authorities
- (B) Gap limit – Caps the risk in forward position mismatches
- (C) Stop-loss limit – Represents the final stage of controlling trading operations
- (D) Deal size limit – Applies exclusively to merchant deals.

Oct/Nov 2017

35. When a bank faces a severe liquidity crisis and cannot dispose of securities due to a bond market collapse, what is the ultimate consequence for the treasury?

- (A) Liquidity risk translates into interest rate risk due to the high cost of emergency borrowing.
- (B) The bank is automatically declared insolvent by the central bank after a single day of crisis.
- (C) The treasury immediately books an equity market profit to offset the loss from bond illiquidity.
- (D) The settlement risk is completely transferred to the clearing corporation to avoid financial loss.

May/June 2008

36. Consider the following statements regarding the Yield to Maturity (YTM) of a bond:

- I. The YTM reveals exactly how volatile bond prices are and how they respond dynamically to changes in interest rates.
- II. Two bonds with the exact same YTM may have different price risks associated with them due to differing maturities or coupon frequencies.

Which of the above statement(s) is/are correct?

- (A) Both I and II are correct
- (B) Both I and II are incorrect
- (C) Only I is correct
- (D) Only II is correct

Oct/Nov 2013

37. Regarding the calculation of aggregate open positions in foreign exchange, which of the following statements is true?

- (A) The currency-wise net position is translated into USD at day-end rates and then into Rupees.
- (B) The currency-wise net position is aggregated strictly based on its native currency volume without translation.
- (C) The Rupee equivalent is calculated directly from native currencies without any intermediate USD conversion.
- (D) Aggregate positions are calculated uniquely for each dealer without combining them at the broader Treasury level.

May/June 2015

38. Arrange the following steps involved in the execution and control of a treasury transaction in the correct chronological sequence:

1. Verification of pricing and MTM valuation by the Mid office.
 2. Execution of the deal by the Front office.
 3. Fixation of counterparty exposure limits by Management.
 4. Independent confirmation and settlement by the Back office.
- (A) 3, 2, 4, 1
 - (B) 2, 4, 1, 3
 - (C) 3, 4, 2, 1
 - (D) 2, 3, 4, 1

Oct/Nov 2012

39. Match the organizational bodies of Treasury in List I with their respective functions in List II.

List I: (Divisions)

- P. Front Office
- Q. Back Office
- R. Mid Office
- S. Top Management

List II: (Functions)

1. Approves the Aggregate Gap Limits and internal trading limits.
 2. Obtains independent confirmation from the counterparty and settles the deal.
 3. Executes lending and borrowing operations with counterparty banks.
 4. Conducts daily mark-to-market valuation and verification of derivative pricing.
- (A) P-3, Q-2, R-4, S-1
 - (B) P-2, Q-4, R-1, S-3

(C) P-4, Q-1, R-3, S-2

(D) P-1, Q-3, R-2, S-4

May/June 2011

40. All of the following are recognized standard approaches used to calculate Value at Risk (VaR), EXCEPT:

- (A) Parametric / Variance-Co-Variance approach
- (B) Monte Carlo simulation approach
- (C) Historical data approach
- (D) Macaulay Duration optimization approach

Oct/Nov 2020

41. Consider the following statements regarding Duration:

- I. Modified Duration is calculated by multiplying the Macaulay duration by the prevailing interest rate yield.
 - II. Since bond prices move in direct proportion to yields, a 5 bps rise in yield causes the price of the bond to uniformly rise by 5 bps.
- Which of the above statement(s) is/are correct?

- (A) Both I and II are correct
- (B) Both I and II are incorrect
- (C) Only I is correct
- (D) Only II is correct

May/June 2022

42. Identify the incorrect statement regarding the segregation of treasury functions.

- (A) Front office and Back office functions need to be segregated totally.
- (B) Front office reports independently to the Treasury Head.
- (C) Mid office is strictly required to report to the Front Office Chief Dealer.
- (D) Back office reports independently to the Operations Head.

Oct/Nov 2023

43. Match the following Treasury Risk Management terms in List I with their corresponding descriptions in List II.

List I: (Terms)

- P. Delivery versus Payment (DvP)
- Q. Real Time Gross Settlements (RTGS)
- R. Mark to Market (MTM)
- S. Cost of Carry

List II: (Descriptions)

1. Inter-bank payments effected instantly by debit and credit via RBI platform.

2. Interest cost of funds locked in a trading position.
 3. Simultaneous debit and credit of funding and securities accounts.
 4. Valuation of trading positions applying current market rates at day end.
- (A) P-3, Q-1, R-4, S-2
(B) P-1, Q-3, R-2, S-4
(C) P-4, Q-2, R-1, S-3
(D) P-3, Q-4, R-1, S-2

May/June 2023

44. Which scenario best illustrates the concept of 'Macro-hedging' in a bank's asset-liability management?
- (A) Entering into an interest rate swap to protect a single corporate bond against specific rate hikes.
- (B) Setting an overnight Value at Risk (VaR) limit for the entire foreign exchange trading desk operation.
- (C) Imposing a gap limit strictly on forward foreign exchange merchant deals to reduce residual risk.
- (D) Hedging the difference between the aggregate duration of balance sheet assets and liabilities.

Oct/Nov 2018

45. Consider the following statements regarding treasury risk management:
- I. Treasury risk management involves dealing with market risk generated by other operational departments as well as treasury's own market opportunities.
- II. In treasury operations, the risk of loss is strictly 'capped' by the principal amount invested, exactly mirroring the credit business.
- Which of the above statement(s) is/are correct?
- (A) Both I and II are correct
(B) Both I and II are incorrect
(C) Only I is correct
(D) Only II is correct

May/June 2016

46. Which of the following statements regarding Value at Risk (VaR) is incorrect?
- (A) VaR indicates the worst possible movement of a market rate over a given period at a defined confidence level.
- (B) VaR is a perfectly accurate measure for very

long periods, completely eliminating the need for back-testing exercises.

- (C) VaR is widely used to measure overnight risk or risk over short periods, such as over one month.
- (D) VaR is additive across different asset classes, such as currencies, bonds, and derivatives.

Oct/Nov 2009

47. Which of the following pairs of derivative instruments and their primary use in treasury risk management is correctly matched?
- (A) Interest Rate Swap – To exchange default risk of a counterparty
- (B) Forward Rate Contract – To avoid exchange rate risk
- (C) Commodity Option – To hedge bank's direct exposure in domestic equity markets
- (D) Continuous Linked Settlement – To hedge balance sheet duration gap

May/June 2007

48. The essential responsibilities of the Mid office in a bank's treasury include all of the following, EXCEPT:
- (A) Monitoring compliance with risk limits set in the respective policies.
- (B) Execution of foreign exchange and securities deals with counterparty banks.
- (C) Daily mark-to-market (MTM) valuation of Treasury positions.
- (D) Verification of pricing of treasury products, including derivatives.

Oct/Nov 2025

49. Match the following Treasury Limits in List I with their primary characteristic or purpose in List II.
- List I: (Limits)
- P. Deal Size Limit
Q. Stop-loss Limit
R. Daylight Limit
S. Gap Limit
- List II: (Characteristics)
1. Caps the residual time mismatches for forward positions.
 2. Pertains to intra-day unmatched buy/sell trading positions.
 3. Corresponds to the marketable size of a single transaction to protect against potential deal loss.
 4. Prevents a dealer from waiting indefinitely

ANSWERS

1. (D) Default risk

Default risk arises when a counterparty fails to fulfill contractual obligations, such as repaying a loan or principal amount. In the inter-bank market, this occurs when a borrowing institution becomes insolvent or faces bankruptcy, resulting in a loss for the lender. This credit-related risk is a fundamental concern in money market lending operations.

2. (C) The degree of fluctuation in variables like interest and exchange rates, measured as standard deviation from the mean.

Volatility represents the magnitude of price movements for a financial instrument over time. It is statistically measured using standard deviation, reflecting the dispersion of variables like interest rates or exchange rates from their mean. Higher volatility indicates greater market uncertainty and risk, as prices fluctuate more significantly within a specific period compared to historical averages.

3. (C) Stop-loss limit

Stop-loss limits are essential control mechanisms designed to prevent traders from holding losing positions indefinitely in hopes of a market recovery. When losses reach a predefined threshold, the position must be closed immediately to protect capital. This measure ensures discipline and limits the potential downside from adverse market movements during active trading sessions.

4. (C) All intermittent cash flows are reinvested at the uniform discount rate of the bond.

Yield to Maturity is a mathematical concept that calculates the internal rate of return for a fixed-income security. It fundamentally assumes that all periodic coupon payments or intermittent cash flows received before maturity are reinvested at the same rate as the bond's yield. This uniform reinvestment rate is critical for determining the total return of the investment.

5. (B) Rs. 40 lakhs

To estimate Value at Risk for a multi-day period, the overnight figure is multiplied by the square root of the number of days. For a sixteen-day horizon, the square root of sixteen is four. Multiplying the ten-lakh overnight risk by four results in an estimated potential loss of forty lakhs under normal market trading conditions.

6. (B) The risk is measured by 'gaps' representing residual time for completion, which are capped with a gap limit.

Forward positions involve future settlements where price risk remains due to interest rate differentials over time. These risks are managed by identifying maturity mismatches, commonly referred to as gaps. Management imposes specific gap limits to control the volume of these mismatches, ensuring that the residual risk from forward transactions remains within the institution's predefined risk appetite.

7. (B) Leverage

Leverage is a powerful financial tool that allows treasury departments to control large market positions using relatively small amounts of capital or margin. By facilitating transactions that far exceed the actual cash reserves deployed, leverage magnifies both potential profits and potential losses. This operational ability is a defining characteristic of modern trading and foreign exchange markets.

8. (B) The risk that movements in equity, interest, currency, and commodity markets will adversely affect position values.

Market risk is defined by international standards as the potential for financial loss resulting from adverse movements in market prices. This broad category encompasses risks related to interest rates, foreign exchange rates, equity prices, and commodity values. It specifically addresses how fluctuations in these variables impact the valuation of the trading book and the overall financial health of banks.

- (B) The longer the duration, the greater the sensitivity of the bond price to changes in interest rates.
- (C) Duration represents the weighted average measure of the life of a bond.
- (D) Duration helps compare bonds with different structures to find out which entails greater interest rate risk.

Oct/Nov 2022

57. Which of the following pairs of risk types and their definitions is incorrectly matched?
- (A) Unsystematic risk – Risk associated with the entire market segment
 - (B) Price risk – Confluence of liquidity, interest rate, exchange rate, equity, and commodity risk
 - (C) Credit risk – Potential loss in loan assets capped by the amount invested
 - (D) Liquidity risk – Inability to bridge cash flow gaps, translating into interest rate risk

May/June 2018

58. Exposure limits for counterparties are fixed on the basis of several parameters to avoid concentration of risk. Which of the following is NOT typically one of those determining parameters?
- (A) The specific number of employees in the counterparty bank
 - (B) The counterparty's net worth
 - (C) The counterparty's market reputation and track record
 - (D) The counterparty's credit rating

Oct/Nov 2016

59. Match the following risk concepts in List I with their specific manifestations in Treasury in List II.

List I: (Risks)

- P. Default Risk
- Q. Settlement Risk
- R. Liquidity Risk
- S. Systematic Risk

List II: (Manifestations)

1. Risk associated with the entire market or segment thereof.
2. Cash flow gaps which could not be bridged, threatening operations.
3. A borrowing bank fails to repay the money market loan on due date.
4. A counterparty fails to deliver their leg of a

transaction across different time zones.

- (A) P-4, Q-2, R-3, S-1
- (B) P-1, Q-3, R-2, S-4
- (C) P-3, Q-4, R-2, S-1
- (D) P-2, Q-1, R-4, S-3

May/June 2014

60. Why are the management prescribe 'Limits on Deal Size' predominantly for trade deals and not strictly for merchant deals?
- (A) Because merchant deals are executed exclusively in the domestic equity market.
 - (B) Because merchant deals are generally covered back-to-back, neutralizing the market risk.
 - (C) Because trade deals involve smaller volumes and are inherently immune to volatility.
 - (D) Because the RBI forbids placing limits on any transactions involving retail clients.

Oct/Nov 2007

61. Consider the following statements regarding Market Risk components:
- I. Treasury faces liquidity risk when it cannot readily sell an acquired government security because the bond market collapses.
 - II. Interest rate risk is present wherever there is a mismatch between maturing assets and liabilities.
 - III. Currency risk is solely a manifestation of equity market movements and is totally unrelated to global interest rates.
 - IV. Free markets are highly susceptible to speculation, where perceptions of future changes direct market movements.

Which of the above combination of statements is correct?

- (A) I, II, and III only
- (B) I, II, and IV only
- (C) II, III, and IV only
- (D) I, III, and IV only

May/June 2025

62. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer using the options given below.

Assertion (A): Yield and the traded price of a bond move in inverse proportion to each other.
Reason (R): The yield represents the internal rate of return at which the present value of cash

- I. Limits on deal size apply exclusively to trade deals, as merchant deals are covered back-to-back.
- II. Daylight open position limits are generally larger than overnight open position limits.
- III. Capital needs to be maintained at a specific regulatory percentage on the higher of the Net Overnight Open Position Limit or the Outstanding position.
- IV. Cost of carry arises because the Treasury loses interest on foreign currency funds held during an open position period.

Which of the above combination of statements is correct?

- (A) I, II, and IV only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2023

73. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer using the options given below.

Assertion (A): Modified duration alone is a perfectly accurate measure for determining bond price changes regardless of the size of the yield shift.

Reason (R): The modified duration measure requires convexity adjustments for greater accuracy because the actual yield curve is rarely a straight line.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2024

74. Evaluate the following statements regarding derivatives, risk management, and terminology:
- I. Derivatives derive their value based on an underlying market for a commodity or financial product.
 - II. Interest rate swaps can be used to convert a fixed rate of interest into a floating rate.
 - III. A forward rate contract can be effectively utilized to avoid exchange rate risk.

- IV. 'Mismatch' refers strictly to physical differences in the aggregate principal amounts of assets and liabilities, ignoring timing.
- V. 'Off-balance sheet' items include forward contracts, interest rate swaps, and letters of credit.

Which of the above combination of statements is correct?

- (A) I, II, III, and IV only
- (B) I, II, III, and V only
- (C) II, III, IV, and V only
- (D) I, II, IV, and V only

Oct/Nov 2008

75. Consider the following statements about Exposure Ceilings in Treasury:

- I. Exposure limits are kept in place primarily to protect the bank from internal operational fraud by dealers.
- II. Default risk typically materializes when a borrowing bank fails to repay a money market loan on the due date.
- III. Exposure limits for counterparties are fixed taking into account their net worth, market reputation, and credit rating.
- IV. Regulatory guidelines often impose a ceiling of 5% of total business in a year for individual money market brokers.

Which of the above combination of statements is correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

May/June 2006

76. Evaluate the following statements about the role and controls of a Bank Treasury:

- I. Treasury manages both its own market opportunities and the market risk generated by other balance sheet departments.
- II. The loss potential in treasury is strictly capped at the principal and interest invested, identically to the credit business.
- III. Losses in treasury materialize in the very short-term, and confirmed transactions are generally irrevocable.
- IV. Mid office functions should be integrated with Front office operations and report to the Chief Dealer.
- V. The Back office meticulously verifies rates

the ruling interest rates, where PV of cash flows equals the market price.

- III. A bond traded at a discount of 2% implies that the prevailing market rate of interest is lower than the coupon rate.
- IV. Modified Duration indicates the price sensitivity of a bond per unit of change in the yield levels.

Which of the above combination of statements is correct?

- (A) I, II, and III only
(B) I, II, and IV only
(C) II, III, and IV only
(D) I, III, and IV only

May/June 2017

68. Consider the following statements regarding Duration:

- I. The duration of a zero-coupon bond is equal to its time to maturity, as there are no interim cash flows.
- II. A portfolio manager can immunize a portfolio from interest rate risk by keeping the average duration equal to the target holding period.
- III. The actual yield curve is almost always a straight line, making Modified Duration perfectly accurate without any convexity adjustments.

Which of the above statements are correct?

- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

Oct/Nov 2005

69. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer using the options given below.

Assertion (A): Even when a foreign exchange swap deal results in perfectly matched purchase and sale amounts, there is still scope for loss.

Reason (R): Forward prices are derived from interest rate differentials, creating an opportunity cost if interest rates move adversely during the residual time for completion of the transaction.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

(C) Assertion (A) is true, but Reason (R) is false.

(D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

70. Evaluate the following statements regarding the Yield to Maturity (YTM) and Duration of bonds:

- I. YTM calculates the effective rate of return assuming all intermittent cash flows are reinvested at a uniform discount rate.
- II. The YTM of two different bonds guarantees identical price volatility even if their maturities or coupons are different.
- III. Duration weights the time of receipt of a cash flow by the present value (PV) of that specific cash flow.
- IV. The aggregate result of time-weighted PVs is divided by the total PV of all cash flows to yield Macaulay Duration.
- V. Modified duration provides an exact calculation for extremely large price changes without needing any convexity adjustment.

Which of the above combination of statements is correct?

- (A) I, II, and III only
(B) I, III, and IV only
(C) III, IV, and V only
(D) I, III, IV, and V only

Oct/Nov 2021

71. Consider the following statements about bank treasury controls:

- I. Forward transactions are revalued periodically, and outstanding positions in each time bucket are subjected to gap limits.
- II. A single transaction value in larger banks may range from Rs. 5 crore to Rs. 50 crore at the discretion of the Treasurer.
- III. Stop-loss limits are strictly applied per deal, and cannot be aggregated per day, per month, or per year.

Which of the above statements are correct?

- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

May/June 2013

72. Consider the following statements about Internal Controls in Forex Treasury:

for an adverse market to turn around.

- (A) P-2, Q-1, R-4, S-3
- (B) P-4, Q-3, R-1, S-2
- (C) P-3, Q-4, R-2, S-1
- (D) P-1, Q-2, R-3, S-4

May/June 2012

50. In the context of foreign exchange exposure across different time zones, what is the primary advantage of utilizing the Continuous Linked Settlements (CLS) mechanism?

- (A) It eliminates market risk by locking in forward exchange rates for all cross-border transactions.
- (B) It guarantees high leverage for intraday trading positions across major international currencies.
- (C) It uses a Payment versus Payment (PvP) mechanism to virtually eliminate settlement risk.
- (D) It replaces the need for standard VaR calculations on currency portfolios in global treasury units.

Oct/Nov 2014

51. Consider the following statements about treasury organizational controls:

- I. The back office must verify that the rates mentioned in the deal slips conform to the market rates at the time the deal was entered into.
- II. The front office is solely responsible for daily mark-to-market (MTM) valuation of treasury positions to monitor ALM guidelines.

Which of the above statement(s) is/are correct?

- (A) Both I and II are correct
- (B) Both I and II are incorrect
- (C) Only I is correct
- (D) Only II is correct

May/June 2019

52. According to the BIS definition and treasury practices, the main components of market risk include all of the following, EXCEPT:

- (A) Liquidity risk
- (B) Currency risk
- (C) Interest rate risk
- (D) Default risk

Oct/Nov 2006

53. What is the primary purpose of applying a 'Convexity' adjustment to the Modified Duration measure?

- (A) To convert the duration from an absolute currency value into a percentage of total assets.
- (B) To measure the default risk of the bond issuer over a long-term economic or credit horizon.
- (C) To correct the limitation of assuming a linear yield curve for greater accuracy.
- (D) To isolate the equity risk component embedded within a convertible or standard coupon bond.

May/June 2021

54. Which of the following pairs of Treasury concepts and their underlying metrics is correctly matched?

- (A) Modified Duration – Second order derivative of duration
- (B) Convexity – First order derivative of duration
- (C) Macaulay Duration – Weighted average measure of life of a bond
- (D) Volatility – Weighted present value of cash flows

Oct/Nov 2010

55. Arrange the following steps involved in arriving at the aggregate foreign exchange open position in the correct chronological order:

1. The USD equivalent is converted into Rupees.
 2. The aggregate position is checked against the pre-approved overnight limits.
 3. The currency-wise net position is determined.
 4. The net position is translated into USD at the day-end rate.
- (A) 3, 1, 4, 2
 - (B) 4, 3, 1, 2
 - (C) 3, 4, 1, 2
 - (D) 1, 3, 4, 2

May/June 2005

56. Which of the following statements about Duration is incorrect?

- (A) The duration of a zero-coupon bond is always substantially less than its time to maturity.

from information terminals at regular intervals to ensure objective pricing.

Which of the above combination of statements is correct?

- (A) I, III, and V only
- (B) I, II, IV, and V only
- (C) II, III, and IV only
- (D) I, III, IV, and V only

Oct/Nov 2017

77. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer using the options given below.

Assertion (A): An overnight open position limit is generally fixed at a much higher amount than a daylight open position limit.

Reason (R): During the night, the foreign exchange market remains active globally, but domestic dealers do not track the positions, thereby significantly increasing the risk.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2008

78. Consider the following statements about Treasury operations:

- I. The front office operations are primarily headed by the Treasury Head.
- II. The Mid office maintains the overall risk profile of the Treasury and verifies the pricing of treasury products.
- III. Treasury manages the bank's liquidity through money market operations to meet internal funding requirements.

Which of the above statements are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2013

79. Consider the following statements regarding Treasury Limits:

- I. Stop-loss limits prevent dealers from

holding losing open positions indefinitely.

- II. Aggregate Gap Limit (AGL) for forward positions is internally approved and subject to regulatory caps relative to the Bank's Capital.
- III. For non-statutory securities, a minimum credit rating requirement is prescribed by regulators and may be dictated by Bank Management.
- IV. Stop-loss limits in securities trading are applied based on the mark-to-market value of the trading portfolio, using measures like VaR and duration.

Which of the above combination of statements is correct?

- (A) I, II, and III only
- (B) I, II, and IV only
- (C) I, III, and IV only
- (D) II, III, and IV only

May/June 2015

80. Evaluate the following statements regarding segregation and responsibilities in Treasury:

- I. The Front office may enter into currency dealings on its own trading book or on behalf of clients.
- II. The Back office settles a deal only if it is verified to be within the allowed exposure limits for the counterparty.
- III. The Mid office conducts independent confirmation of each and every deal directly with the counterparty.
- IV. The Back office has overall responsibility for compliance with exposure and position limits.
- V. Mid office prepares periodic reports to the top management regarding the overall risk profile of the Treasury.

Which of the above combination of statements is correct?

- (A) I, II, IV, and V only
- (B) I, II, III, and V only
- (C) I, III, IV, and V only
- (D) II, III, IV, and V only

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flows equals the market price; therefore, if the market price falls, the fixed cash flows represent a higher percentage return.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2019

63. Consider the following statements regarding settlement risk:

- I. Settlement risk arises solely due to the physical barriers of different time zones in foreign exchange transactions, never from bankruptcies.
- II. Delivery of government securities minimizes settlement risk because both securities and funding accounts are with the central bank, allowing simultaneous debit and credit.
- III. The Payment versus Payment (PvP) mechanism addresses settlement risk to a considerable extent.

Which of the above statements are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2009

64. Evaluate the following statements regarding market volatility, risks, and VaR:

- I. Volatility in the currency market is known as volatility of exchange rates.
- II. Systematic risk is an isolated risk uniquely associated with a particular individual investment.
- III. The parametric approach to VaR relies on volatility and uses a normal distribution curve to determine worst possible movements.
- IV. The historical data approach for VaR may assign progressive weights to more recent information.
- V. Monte Carlo simulation generates random scenarios to study the impact on stock prices or exchange rates.

Which of the above combination of statements is correct?

- (A) I, III, IV, and V only
- (B) I, II, III, and IV only
- (C) II, III, IV, and V only
- (D) I, II, IV, and V only

Oct/Nov 2011

65. Consider the following statements regarding Value at Risk (VaR):

- I. VaR implies a potential loss at a defined confidence level over a given period under normal market conditions.
- II. VaR is additive across different asset classes such as Currency, Bonds, and Derivatives.
- III. VaR for longer periods is extrapolated by multiplying the overnight VaR directly by the total number of days without any mathematical adjustment.

Which of the above statements are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2010

66. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer using the options given below.

Assertion (A): Bank management is highly sensitive to treasury risk compared to credit risk. Reason (R): Treasury business enjoys high leverage, allowing massive buy and sell positions with very low funding requirements, which can result in a loss of capital disproportionate to the funds invested.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2024

67. Consider the following statements on Bond Yields and Prices:

- I. The traded price of a bond is dynamically based on the market rate of interest for the residual period.
- II. Yield is the internal rate of return reflecting

9. (B) 5%

The Reserve Bank of India mandates strict internal controls to prevent business concentration with any single intermediary. Banks must ensure that the total volume of business conducted through an individual foreign exchange or money market broker does not exceed five percent of their total annual brokerage business. This regulatory ceiling promotes fair competition and reduces institutional dependence on specific brokers.

10. (C) Continuous Linked Settlements (CLS)

Continuous Linked Settlements is a specialized global mechanism designed to mitigate settlement risk in foreign exchange transactions. It operates on a Payment versus Payment basis, ensuring that the settlement of one currency occurs only if the settlement of the other currency takes place simultaneously. This effectively eliminates the risk of a counterparty defaulting during cross-border time zone differences.

11. (D) It obtains independent confirmation of deals and is responsible for their settlement.

The back office plays a critical role in treasury operations by providing independent verification of all trades executed by the front office. Its primary responsibilities include obtaining direct confirmations from counterparties, reconciling transaction details, and managing the actual settlement of funds and securities. This segregation of duties is essential for maintaining internal control and preventing unauthorized or fraudulent activities.

12. (C) Mid office

The mid office serves as the risk management hub within a treasury department. It is responsible for monitoring compliance with established risk limits, performing daily mark-to-market valuations, and verifying the accuracy of pricing for various products. By reporting independently to senior management, this unit ensures that trading activities remain within the bank's approved risk profile and Asset-Liability Management guidelines.

13. (A) Differences in duration of assets and liabilities, or sources and uses of funds with varying payment terms and maturities.

Mismatch refers to the discrepancy between the maturities or durations of assets and liabilities.

In treasury management, this occurs when the timing of cash inflows from investments does not align with the timing of cash outflows for obligations. Managing these gaps is vital for controlling liquidity and interest rate risks, as variations can impact the bank's net interest margin.

14. (B) Exactly 3 years

Macaulay duration measures the weighted average time until all cash flows from a bond are received. For a zero-coupon bond, there are no interim interest payments, and the only cash flow occurs at the final maturity date. Consequently, the duration is always equal to the bond's remaining time to maturity, representing the full investment period without any earlier returns.

15. (D) The yield curve is rarely a straight line, and rates change at varying speeds, necessitating a convexity adjustment for greater accuracy.

Modified Duration assumes a linear relationship between bond prices and yield changes, which is only accurate for very small fluctuations. In reality, the price-yield relationship is curved, a property known as convexity. Because interest rates change at varying speeds across different maturities, a convexity adjustment is necessary to provide a more precise measurement of price sensitivity.

16. (A) Daylight open position

A daylight open position refers to the unmatched buy or sell commitments held by a dealer during a single trading day. This type of position is used to capitalize on intraday market fluctuations. Although these positions are usually squared before the close of business, they are subject to specific internal limits to manage the risk of rapid price changes.

17. (A) High leverage allows massive exposure with a very low initial capital or funding requirement. Treasury operations involve significantly higher risk of capital loss compared to traditional credit activities because of the high degree of leverage employed. Traders can execute massive transactions with minimal upfront capital, meaning small adverse price movements can lead to losses exceeding the initial investment. This volatility and potential for rapid value

values can indeed range significantly. However, stop-loss limits are not only applied per deal; they are also aggregated per day, month, and year to provide comprehensive protection against cumulative losses, making the third statement regarding their application incorrect.

72. (D) I, II, III, and IV

Deal size limits focus on trade deals because merchant deals are typically covered back-to-back. Daylight limits are larger than overnight limits due to the lack of active monitoring at night. Regulatory capital must be maintained based on the higher of the overnight limit or position. Finally, cost of carry reflects interest lost on funds held in open currency positions.

73. (D) Assertion (A) is false, but Reason (R) is true. Modified Duration is not a perfectly accurate measure for all yield shifts because it assumes a linear relationship that does not exist in reality. However, the reason provided is correct: the actual yield curve is rarely a straight line, and therefore, a convexity adjustment is required to improve the accuracy of price sensitivity measurements when interest rates change significantly.

74. (B) I, II, III, and V only

Derivatives derive value from underlying assets, and swaps can convert fixed rates to floating rates. Forward contracts are used to avoid exchange rate risk, and off-balance sheet items include swaps and letters of credit. However, 'mismatch' refers to more than just principal amounts; it specifically focuses on the timing of cash flows and maturities, making the fourth statement incorrect.

75. (B) II, III, and IV only

Default risk arises when a borrower fails to repay a loan, and counterparty limits are based on net worth, reputation, and credit ratings. Regulatory standards also limit business with individual brokers to five percent. However, exposure limits are primarily designed to manage external credit risk rather than internal fraud by dealers, which is typically addressed through other operational controls.

76. (A) I, III, and V only

Treasury manages both internal and external market risks, and losses can materialize rapidly

in short-term transactions. The back office must verify pricing against objective market data. However, losses can exceed the principal invested due to leverage, and the mid office must remain separate from the front office for effective oversight, making the second and fourth statements in this set incorrect.

77. (D) Assertion (A) is false, but Reason (R) is true. The assertion that overnight limits are higher than daylight limits is incorrect; they are actually much lower to minimize risk when domestic dealers are unavailable. However, the reason is true: the global market remains active while local offices are closed, making unmonitored positions more risky and justifying the much smaller limits placed on positions held throughout the night.

78. (B) II and III only

The mid office maintains the treasury risk profile and verifies pricing, while the treasury department manages the bank's liquidity through money market operations. However, the first statement is slightly inaccurate in its phrasing regarding the head of front office operations, as the focus is on the functions performed by the mid office and the liquidity management role of treasury.

79. (B) I, II, and IV only

Stop-loss limits prevent indefinite losses, and aggregate gap limits are subject to regulatory capital caps. Stop-loss limits in securities trading also utilize measures like Value at Risk and duration. However, the third statement regarding credit ratings for non-statutory securities is more of a regulatory or management policy rather than a standard internal trading limit like the others mentioned in the set.

80. (A) I, II, IV, and V only

The front office manages trading, and the back office ensures deals are within exposure limits while holding responsibility for limit compliance. The mid office monitors the risk profile and reports to management. However, the third statement is incorrect because the back office, not the mid office, is responsible for conducting the independent confirmation of each deal with the counterparty.

- 27.** (A) The market stays active at night while domestic dealers are not available to track price movements.

Foreign exchange markets operate twenty-four hours a day across global financial centers. While a domestic treasury office is closed at night, international markets continue to trade, potentially causing significant price shifts. Because domestic dealers cannot actively manage or react to these movements during non-business hours, overnight open position limits are kept much smaller than daylight limits to minimize unmonitored risk.

- 28.** (B) Rs. 74.55

Value at Risk identifies the potential adverse movement in a price. For an exporter, the risk is that the currency will depreciate, meaning they receive fewer Rupees for their foreign currency. If the VaR is forty-five paise and the current rate is seventy-five Rupees, the worst-case scenario within the defined confidence level would be a rate of seventy-four point fifty-five.

- 29.** (D) 9%

The Reserve Bank of India requires banks to maintain a minimum capital charge to cover the market risk associated with foreign exchange positions. This capital requirement is currently set at nine percent of the higher of the Net Overnight Open Position Limit or the actual outstanding position. This ensures that the bank has sufficient financial cushions against potential losses in its currency portfolio.

- 30.** (D) Modified Duration

Modified Duration is the primary tool used by treasury managers to measure the direct sensitivity of a bond's price to changes in interest rates. It represents the approximate percentage change in the price of a fixed-income security for every one percent change in yield. This measure allows for a standardized comparison of interest rate risk across different bonds in a portfolio.

- 31.** (C) Counterparty exposure ceiling limits

While various limits are placed on individual traders to control market risk, counterparty exposure ceilings are institutional limits focused on credit risk. Deal size limits, open position limits, and stop-loss limits directly restrict a dealer's trading behavior and risk-taking capacity.

In contrast, counterparty ceilings are established by management to ensure the bank's total exposure to a specific entity remains diversified.

- 32.** (B) P-3, Q-2, R-1, S-4

The parametric approach uses statistical variance and normal distribution curves. Monte Carlo simulations generate multiple random scenarios to assess potential impacts. The historical data approach relies on actual past time series data. Finally, back-testing is a crucial process used to verify the accuracy and effectiveness of the Value at Risk models employed by comparing predicted results against actual market outcomes.

- 33.** (B) They allow dealers to wait indefinitely for a market turnaround to close the position with a profit.

Stop-loss limits are strictly designed to prevent dealers from waiting indefinitely for a market turnaround. They mandate the immediate closure of a position once a certain loss threshold is reached. By enforcing this discipline, management ensures that losses are contained and do not escalate to levels that could jeopardize the bank's capital. These limits are applied per deal and over various timeframes.

- 34.** (D) Deal size limit – Applies exclusively to merchant deals.

Deal size limits are primarily applied to trade deals where the bank takes on market risk. Merchant deals are typically covered back-to-back in the inter-bank market, effectively neutralizing the risk. Therefore, the primary focus of size limits is on the bank's own trading activities. Other correctly matched limits include gap limits for forward mismatches and stop-loss limits for controlling trading operations.

- 35.** (A) Liquidity risk translates into interest rate risk due to the high cost of emergency borrowing.

When a bank cannot sell securities due to a market collapse, it faces a severe liquidity crisis. To meet its funding obligations, the bank may be forced to borrow money at excessively high interest rates in the emergency market. This situation demonstrates how liquidity risk directly translates into interest rate risk, significantly increasing the cost of funds and impacting the bank's profitability.

- (D) Reporting follows a confidentiality protocol among representative market bodies

May/June 2025

8. Which of the following best describes the risk profiles of the buyer and seller of a plain vanilla option?
- (A) Both the buyer and the seller face unlimited potential loss in the transaction
- (B) The buyer faces unlimited potential loss, while the seller's risk is limited
- (C) The buyer's risk is limited to the premium, while the seller faces unlimited loss
- (D) Both the buyer and the seller have their risk strictly capped at intrinsic value

Oct/Nov 2022

9. What are the minimum prudential requirements for an AD Category - I bank to become a trading and clearing member of the exchange traded currency options market?
- I. Minimum net worth of Rs. 500 crores.
- II. Minimum CRAR of 10 per cent.
- III. Net NPA should not exceed 3 per cent.
- IV. Made net profit for the last 3 years.
- V. Must hold a specialized license directly from SEBI.
- Which combination of statements is correct?
- (A) I, II, III and IV only
- (B) I, II, IV and V only
- (C) II, III, IV and V only
- (D) I, II, III, IV and V

May/June 2016

10. Consider the following statements regarding the factors that influence an option premium:
- I. Volatility of the underlying market
- II. Expiry date (maturity)
- III. Prevailing interest rates
- IV. Strike price
- V. Credit rating of the option buyer
- Which combination of statements is correct?
- (A) I, II, III and IV only
- (B) I, III, IV and V only
- (C) II, III, IV and V only
- (D) I, II, III, IV and V

Oct/Nov 2018

11. An exporter wishes to book contracts in Exchange Traded Currency Derivatives (ETCDs) on a declaration basis without an underlying. The exporter's average export turnover of the

last three years is Rs. 100 crores, and the previous year's export turnover was Rs. 120 crores. How will the eligible limit up to which they can take appropriate hedging positions be determined?

- (A) The limit is Rs. 100 crores, as the three-year average is the preferred basis
- (B) The limit is Rs. 120 crores, being the higher of the two listed parameters
- (C) The limit is capped at a fixed mandate of Rs. 50 crores regardless of turnover
- (D) The exporter cannot book ETCDs without a documented underlying transaction

May/June 2023

12. Which of the following statements regarding stock options is incorrect?
- (A) A stock option grants the right to buy or sell equity of a company at the strike price.
- (B) If the market price is above the strike price on expiry, a put option holder will prefer to sell shares in the open market.
- (C) A call option on a stock index offers protection against a fall in the index.
- (D) Stock options can be available on individual company shares as well as on stock indices.

Oct/Nov 2006

13. As per extant guidelines on Risk Management and Inter-Bank Dealings regarding cross currency contracts, which of the following statements is incorrect?
- (A) Residents and FPIs need underlying exposure to trade in cross currency contracts
- (B) Cross currency futures and option contracts are available in EUR-USD and USD-JPY pairs
- (C) Exchange traded option contracts are available in pairs of EUR-INR, GBP-INR, and JPY-INR.
- (D) AD Category-I bank trading members may trade subject to their Net Open Position Limit

May/June 2021

14. Match the derivative contract types in List I with their characteristics in List II.
- List I: (Contract Type)
- P. Forward Contract Execution
- Q. Option Contract Execution
- R. Forward Contract Pricing
- S. Option Contract Pricing
- List II: (Characteristic)

45. (C) Only I is correct

Treasury departments manage market risks originating from various bank activities as well as risks from their own trading positions. However, the risk of loss in treasury is not strictly capped at the principal invested, unlike traditional credit business. Due to high leverage and the use of derivative products, potential losses in treasury operations can significantly exceed the initial capital or funding deployed.

46. (B) VaR is a perfectly accurate measure for very long periods, completely eliminating the need for back-testing exercises.

Value at Risk is an estimation tool that carries inherent model risk and is not perfectly accurate, especially over longer horizons. Because it relies on historical assumptions or simulations, its results must be regularly verified through back-testing to ensure they remain relevant to current market conditions. It is primarily effective for short-term risk measurement and cannot eliminate the need for model validation.

47. (B) Forward Rate Contract – To avoid exchange rate risk

A forward rate contract is a common derivative used to lock in a specific exchange rate for a future transaction, effectively eliminating the risk of currency fluctuations. In contrast, interest rate swaps are used to manage rate exposure rather than default risk. Commodity options and continuous linked settlements are specialized tools that address commodity price volatility and settlement risks, respectively.

48. (B) Execution of foreign exchange and securities deals with counterparty banks.

The execution of deals with counterparties is the primary responsibility of the front office. The mid office is specifically designed to be a non-trading unit that monitors risk compliance, performs valuations, and verifies pricing. By keeping deal execution separate from risk monitoring, the bank ensures that there is independent oversight of all trading activities and that established limits are strictly followed.

49. (C) P-3, Q-4, R-2, S-1

Deal size limits protect against large losses from single transactions by restricting them to marketable volumes. Stop-loss limits

prevent dealers from holding losing positions indefinitely. Daylight limits control unmatched trading positions during the active business day. Gap limits are used to manage the residual time mismatches in forward currency positions, ensuring that the bank's exposure to interest rate differentials is controlled.

50. (C) It uses a Payment versus Payment (PvP) mechanism to virtually eliminate settlement risk. The primary benefit of using the Continuous Linked Settlements mechanism is its ability to mitigate settlement risk in the global foreign exchange market. By employing a Payment versus Payment system, CLS ensures that the settlement of one currency leg is contingent upon the successful settlement of the other. This prevents losses that could occur if a counterparty defaults after receiving funds.**51. (C) Only I is correct**

The back office is responsible for verifying that the rates in deal slips align with market rates at the time of execution. However, the mid office, not the front office, is responsible for performing daily mark-to-market valuations and monitoring compliance with risk management and ALM guidelines. This separation of duties is crucial for maintaining an objective and transparent risk control framework.

52. (D) Default risk

Market risk refers to the potential for loss due to changes in market prices or rates, including liquidity, currency, and interest rate risks. Default risk, however, is a type of credit risk that arises from a counterparty's inability to fulfill their financial obligations. While both impact the bank's profitability, they are distinct risk categories with different measurement techniques and management strategies.

53. (C) To correct the limitation of assuming a linear yield curve for greater accuracy.

Modified Duration provides a linear approximation of the relationship between bond prices and yields, which is only accurate for small changes. Since the actual price-yield relationship is curved, or convex, the duration measure becomes less accurate as yield movements increase. Applying a convexity adjustment corrects this error, providing a more precise

36. (D) Only II is correct

Yield to Maturity is a measure of return but does not fully reveal price volatility. Two bonds with the same YTM can exhibit different price risks because of differences in their maturities or coupon structures. Duration, rather than YTM, is the appropriate measure for quantifying how dynamically bond prices respond to interest rate changes. Therefore, relying solely on YTM for risk assessment is insufficient.

37. (A) The currency-wise net position is translated into USD at day-end rates and then into Rupees.

To determine the total exposure across multiple currencies, banks first calculate the net position for each individual currency. These amounts are then translated into a common base currency, typically US Dollars, using the prevailing day-end market rates. Finally, the USD equivalent is converted into the bank's reporting currency, such as Rupees, to assess the aggregate position against approved overnight risk limits.

38. (A) 3, 2, 4, 1

The process begins with management setting counterparty exposure limits to define risk boundaries. Next, the front office executes the deal within those limits. Following the trade, the back office obtains independent confirmations and settles the transaction. Finally, the mid office performs ongoing monitoring, including mark-to-market valuations and verification of pricing, to ensure the overall risk remains within the bank's policy guidelines.

39. (A) P-3, Q-2, R-4, S-1

The front office is responsible for executing market transactions and managing lending or borrowing. The back office handles independent deal confirmation and final settlement. The mid office performs essential risk control functions like daily mark-to-market valuations and price verification. Top management provides strategic oversight by approving overall risk limits, such as aggregate gap limits, and defining the bank's risk appetite.

40. (D) Macaulay Duration optimization approach

Standard methodologies for calculating Value at Risk include the parametric or variance-covariance approach, the historical data approach, and Monte Carlo simulations. These

methods focus on statistical probability and market volatility. While Macaulay Duration is a vital measure for assessing interest rate risk and price sensitivity in bond portfolios, it is not used as a standalone methodology for calculating Value at Risk.

41. (B) Both I and II are incorrect

Modified Duration is calculated by dividing Macaulay duration by one plus the yield, not by multiplying them. Furthermore, bond prices and yields move in inverse proportion, not direct proportion. A rise in yield causes the price of a bond to fall, and the magnitude of this change is determined by the bond's duration rather than a uniform basis point movement.

42. (C) Mid office is strictly required to report to the Front Office Chief Dealer.

For proper internal control, the mid office must be independent of the front office to avoid conflicts of interest. Reporting to the front office chief dealer would compromise the mid office's ability to provide objective risk monitoring and compliance verification. Instead, the mid office should report to a separate risk management function or a senior executive who does not manage trading operations.

43. (A) P-3, Q-1, R-4, S-2

Delivery versus Payment ensures simultaneous transfer of securities and funds. Real Time Gross Settlements facilitate instant inter-bank payments via the central bank. Mark to Market is the process of valuing positions using current market prices at the end of the day. Cost of Carry represents the interest expense incurred on funds used to maintain a specific trading position in the market.

44. (D) Hedging the difference between the aggregate duration of balance sheet assets and liabilities.

Macro-hedging focuses on managing the risk of the entire balance sheet rather than individual transactions. In Asset-Liability Management, this typically involves using derivatives or other financial instruments to hedge the net difference between the aggregate duration of all assets and all liabilities. This approach protects the bank's net interest margin and overall capital from broad fluctuations in market interest rates.

that equates future cash flows to the current price. If the market price decreases, the fixed coupon payments represent a larger percentage of the investment, thereby increasing the effective yield. This mathematical link explains why yields must rise to attract investors when the market value of bonds falls.

63. (B) II and III only

Delivery of government securities involves simultaneous transfer of assets and funds through the central bank, which minimizes settlement risk. The Payment versus Payment mechanism is also a key tool for addressing this risk. However, settlement risk is not exclusively due to time zones; it can also result from a counterparty's financial failure or bankruptcy, making the first statement inaccurate in this context.

64. (A) I, III, IV, and V only

Currency market volatility refers to exchange rate fluctuations. The parametric VaR approach uses normal distribution, while the historical approach can use weighted data. Monte Carlo simulations involve random scenario analysis. However, systematic risk is not an isolated risk for individual investments; it affects the entire market and cannot be diversified away, making the second statement incorrect in this specific combination.

65. (A) I and II only

Value at Risk represents potential losses at a specific confidence level under normal conditions and is considered additive across different asset classes. However, VaR for longer periods is not calculated by simple multiplication. Instead, it requires a mathematical adjustment using the square root of time to accurately reflect how volatility and risk scale over multiple days or months.

66. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Management is highly sensitive to treasury risk because high leverage allows for massive positions with minimal funding. This means that relatively small market movements can lead to rapid capital losses that are disproportionately large compared to the actual funds deployed. Unlike the slower-moving credit business,

treasury losses materialize quickly and can exceed the initial investment, requiring very stringent internal controls.

67. (B) I, II, and IV only

Bond prices are based on market interest rates, and yield represents the internal rate of return at the current market price. Modified Duration correctly indicates price sensitivity to yield changes. However, a bond trading at a discount implies that the prevailing market interest rate is higher than the coupon rate, not lower, which makes the third statement incorrect in this context.

68. (A) I and II only

The duration of a zero-coupon bond equals its maturity, and a portfolio can be immunized by matching its average duration to the target holding period. However, the yield curve is rarely a straight line, which means Modified Duration alone is not perfectly accurate for larger rate changes. Convexity adjustments are necessary to account for the non-linear relationship between prices and yields.

69. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Even when purchase and sale amounts are matched in a swap, price risk remains because forward prices are linked to interest rate differentials. If interest rates change during the life of the swap, the opportunity cost or the valuation of the forward leg can shift, leading to a potential loss. This highlights the importance of managing the interest rate component of swaps.

70. (B) I, III, and IV only

YTM assumes uniform reinvestment of cash flows, and Macaulay Duration is calculated by dividing the time-weighted present values of cash flows by the total present value. However, YTM does not guarantee identical volatility for different bonds, and Modified Duration is not perfectly accurate for large price changes without convexity adjustments. Therefore, the second and fifth statements are incorrect in this evaluation.

71. (A) I and II only

Forward transactions are periodically revalued and managed using gap limits across different time buckets. In larger banks, single transaction

estimation of price changes for larger shifts in market interest rates.

- 54.** (C) Macaulay Duration – Weighted average measure of life of a bond

Macaulay Duration represents the weighted average time until all cash flows from a bond are received, serving as a measure of the instrument's life. Modified Duration is actually the first-order derivative of the price with respect to yield, while convexity is the second-order derivative. Volatility is a statistical measure of price fluctuation rather than a weighted present value of cash flows.

- 55.** (C) 3, 4, 1, 2

The process starts with determining the net position for each individual currency. Next, these currency-wise positions are translated into US Dollars at the day-end rates. The resulting USD equivalent is then converted into Rupees to find the total aggregate exposure. Finally, this aggregate position is checked against the bank's pre-approved overnight limits to ensure compliance with risk management policies.

- 56.** (A) The duration of a zero-coupon bond is always substantially less than its time to maturity.
The Macaulay duration of a zero-coupon bond is exactly equal to its time to maturity. Since all cash flows occur only at the final maturity date, there are no interim interest payments to shorten the duration period. Other statements regarding duration's role in measuring price sensitivity and comparing interest rate risks across different bond structures remain fundamentally correct in financial theory.

- 57.** (A) Unsystematic risk – Risk associated with the entire market segment

Unsystematic risk is specific to an individual investment or company and can be mitigated through diversification. In contrast, systematic risk is associated with the entire market or segment and cannot be eliminated by diversifying a portfolio. Other definitions, such as price risk encompassing various market factors and liquidity risk potentially leading to higher interest costs, are accurately described within financial frameworks.

- 58.** (A) The specific number of employees in the counterparty bank

Exposure limits are fixed based on financial and qualitative indicators that reflect a counterparty's ability to fulfill obligations. Key parameters include net worth, credit rating, and market reputation. The number of employees is an operational detail and does not provide meaningful information regarding creditworthiness or financial stability. Therefore, it is not used as a determining factor for setting exposure ceilings.

- 59.** (C) P-3, Q-4, R-2, S-1

Default risk manifests when a borrower fails to repay a loan on time. Settlement risk occurs when a counterparty fails to deliver one side of a cross-border transaction. Liquidity risk arises when cash flow gaps cannot be bridged, threatening ongoing operations. Systematic risk refers to broad market movements that affect all participants within a specific segment or the entire economy.

- 60.** (B) Because merchant deals are generally covered back-to-back, neutralizing the market risk.

Banks impose deal size limits on trade deals because the treasury directly absorbs the market risk for these transactions. Merchant deals, which involve client-facing transactions, are usually neutralized by the treasury through immediate offsetting trades in the inter-bank market. Since the market risk for merchant deals is transferred or covered, strict size limits on the initial transaction are less critical for risk management.

- 61.** (B) I, II, and IV only

Treasury faces liquidity risk if it cannot sell securities during a market collapse and interest rate risk when asset-liability maturities are mismatched. Free markets are also influenced by speculation based on future perceptions. However, currency risk is not solely related to equity movements; it is significantly impacted by interest rate differentials and other macroeconomic factors, making the third statement incorrect.

- 62.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Yield and bond prices share an inverse relationship because the yield is the discount rate

CHAPTER 24

Derivative Products

Oct/Nov 2007

1. Consider the following statements concerning the documentation of derivative contracts:
 - I. Banks and counterparties need to execute an ISDA Master Agreement before entering into any derivative contracts.
 - II. The ISDA Master Agreement requires a new, distinct transaction-wise agreement to be drafted from scratch for every subsequent trade.

Which of the statements is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

May/June 2019

2. Following the sub-prime crisis of 2008-2009, which specific type of option exercise style was restricted in the Indian OTC derivative market by regulators?
 - (A) American type option
 - (B) European type option
 - (C) Asian type option
 - (D) Bermudan type option

Oct/Nov 2023

3. In the event of any dispute regarding a specific derivative transaction executed under ISDA standards, which document's terms will rule superior?
 - (A) The Trade Confirmation
 - (B) The ISDA Master Agreement
 - (C) The Schedule to the Master Agreement
 - (D) The FEDAI Rulebook

May/June 2005

4. An investor holds a USD put/JPY call option for USD 1 million with a strike price of 105 JPY per USD and expiry after 3 months. On the expiry date, the market exchange rate is 108 JPY per USD. What is the most rational action for the investor?
 - (A) Exercise the put option immediately and sell USD at the strike price of 105 JPY

- (B) Decline to exercise, as more yen per dollar is available in the open market
- (C) Exercise the option and insist on receiving physical delivery of 1 million JPY
- (D) Rollover the option to the next expiry date by paying the intrinsic value difference

Oct/Nov 2014

5. As per FBIL's extant methodology for calculating the MIFOR, which entity acts as the calculating agent?
 - (A) CCIL
 - (B) RBI
 - (C) FIMMDA
 - (D) NSE

May/June 2012

6. Match the option moneyness condition in List I with its description in List II.

List I: (Condition)

P. At-the-money (ATM) Call Option

Q. In-the-money (ITM) Call Option

R. Out-of-the-money (OTM) Put Option

S. In-the-money (ITM) Put Option

List II: (Description)

 1. Strike price is more than the forward rate
 2. Strike price is less than the forward rate
 3. Strike price is less than the forward rate
 4. Strike price is the same as the forward rate
 - (A) P-4, Q-2, R-3, S-1
 - (B) P-1, Q-3, R-2, S-4
 - (C) P-4, Q-3, R-1, S-2
 - (D) P-2, Q-4, R-1, S-3

Oct/Nov 2009

7. Which of the following statements regarding the reporting of inter-bank derivative trades is incorrect?
 - (A) All inter-bank OTC foreign exchange derivative trades must be reported
 - (B) Corporates must directly report selective OTC trades on the NSE platform
 - (C) Most derivative trades are reported to the CCIL platform for surveillance

erosion necessitate stringent risk management and internal controls.

18. (A) Settlement risk

Settlement risk, often called Herstatt risk, arises when there is a lag between the delivery of one currency and the receipt of another. This typically occurs in international transactions across different time zones. If one party fulfills its obligation while the counterparty fails to do so before its own settlement window, the first party faces a total loss of principal.

19. (C) 6 times

The Aggregate Gap Limit is a regulatory and internal control that caps the total volume of forward exchange mismatches a bank can carry. Regulatory standards typically restrict this limit to six times the bank's Net Open Position Limit (NOPL). This constraint ensures that the potential losses from interest rate differentials and forward pricing movements do not threaten the financial stability or solvency of the institution.

20. (B) A fall of 12 basis points

Bond prices move in the opposite direction of yields. Using Modified Duration, the percentage change in price is calculated by multiplying the duration by the change in yield. A yield increase of five basis points with a duration of two point thirty-eight results in an approximate price decrease of twelve basis points. This formula provides a quick estimate of interest rate sensitivity.

21. (C) Yield and price of a bond move in inverse proportion to each other.

The relationship between a bond's yield and its market price is fundamentally inverse. When market interest rates rise, new bonds offer higher coupons, making existing bonds with lower rates less attractive and causing their prices to fall. Conversely, when rates decline, existing bonds become more valuable, driving their prices up. This inverse movement is a core principle of fixed-income mathematics.

22. (B) A senior executive independent of Treasury operations.

To ensure effective risk oversight and maintain a proper system of checks and balances, the mid office must remain independent from the trading

functions. Ideally, it should report to a senior executive or risk committee that has no direct responsibility for generating treasury profits. This structural segregation prevents conflicts of interest and ensures that risk limits are monitored objectively.

23. (D) Parametric Approach

The parametric approach, also known as the variance-covariance method, calculates Value at Risk by assuming that market returns follow a normal distribution. It relies on statistical measures such as mean, standard deviation, and correlations between different assets. This methodology allows banks to estimate the maximum potential loss within a specific confidence level based on historical volatility and current portfolio exposures.

24. (D) The square root of n

In financial risk management, Value at Risk is typically calculated for a single day. To extend this estimate to a longer time horizon, the overnight VaR is mathematically adjusted by multiplying it by the square root of the number of days in the period. This scaling factor accounts for the way volatility typically increases over time in a random walk process.

25. (B) The interest cost of funds locked in a trading position.

Cost of carry represents the net financial impact of holding a specific asset or trading position over time. In a treasury context, it primarily refers to the interest expense incurred on the funds borrowed or utilized to finance the position. If the income generated by the asset is lower than the cost of funding it, the bank incurs a negative carry.

26. (D) Back office

The back office is responsible for the post-trade administrative and settlement processes. This includes obtaining independent confirmations from counterparties to verify deal terms and ensuring that transactions do not violate established exposure limits. By functioning separately from the front office, the back office provides a critical control layer that validates the accuracy and legitimacy of all treasury dealings before final settlement.

1. The holder has a right but no obligation
 2. Premium is payable front-end
 3. Must be executed at contracted rate on expiry date
 4. Quoted rate includes bank margin with no upfront fee
- (A) P-3, Q-1, R-4, S-2
(B) P-1, Q-2, R-3, S-4
(C) P-4, Q-3, R-2, S-1
(D) P-2, Q-4, R-1, S-3

Oct/Nov 2010

15. Under the guidelines for Interest Rate Options, eligible entities can undertake transactions in specific instruments. Which of the following correctly describes the exercising property of the permitted options?
- (A) American options that can be exercised at any time before final expiration
(B) Bermudan options that can be exercised on several pre-set multiple dates
(C) Asian options where the payoff is determined by the average underlying price
(D) European options exercisable only at the expiration date of the contract

May/June 2007

16. How are "Futures" fundamentally defined within derivative markets?
- (A) Flexible OTC contracts negotiated directly between two parties with custom settlement
(B) Debt instruments with embedded options allowing for premature withdrawal of capital
(C) Standardized forward contracts traded on an exchange with prefixed settlement dates
(D) Agreements where the underlying notional principal must be physically exchanged early

Oct/Nov 2025

17. Arrange the following events related to the Financial Benchmarks India Pvt Ltd (FBIL) in the correct chronological order:
- I. Enactment of the Companies Act under which FBIL was registered.
 - II. Formation of FBIL as a private limited company.
 - III. Commencement of operations with the publication of FBIL-Overnight MIBOR.
- (A) I, II, III
(B) II, I, III

- (C) III, II, I
(D) I, III, II

May/June 2018

18. In the Indian market, when did trading in cross-currency futures contracts (such as Euro/INR, GBP/INR, and JPY/INR) commence?
- (A) Last quarter of 2009
(B) August 2008
(C) June 2003
(D) April 2007

Oct/Nov 2016

19. Consider the following statements regarding the announcement of the FBIL Overnight MIBOR:
- I. The benchmark rate is announced on a daily basis, including Saturdays, Sundays, and local holidays.
 - II. The rate is calculated based on actual call money transactions data.
 - III. The data is obtained from the NDS-call platform of Clearing Corporation of India Ltd (CCIL).
 - IV. The standard announcement time is 10.45 AM every day.
- Which combination of statements is correct?
- (A) I, II and III only
(B) II, III and IV only
(C) I, III and IV only
(D) I, II, III and IV

May/June 2014

20. Consider the following statements regarding the contract sizes of currency futures traded in India:
- I. The contract size for USD/INR is one unit denoting USD 1000.
 - II. The contract size for JPY/INR is one unit denoting 1000 JPY.
 - III. The contract size for Euro/INR is one unit denoting 1000 Euro.
- Which of the above statement(s) is/are correct?
- (A) I only
(B) I and II only
(C) I and III only
(D) I, II and III

Oct/Nov 2019

21. FBIL announces the benchmark matrix of FC-Rupee Options Volatilities for several specific tenors. Which of the following is NOT one of the tenors announced for these volatilities?

- (A) P-3, Q-1, R-4, S-2
- (B) P-1, Q-4, R-2, S-3
- (C) P-4, Q-2, R-1, S-3
- (D) P-2, Q-3, R-4, S-1

Oct/Nov 2021

73. Consider the following statements comparing Interest Rate Swaps (IRS) and Forward Rate Agreements (FRA):

- I. While IRS covers a series of periodical interest payments, an FRA is for a single payment in the future.
- II. Both IRS and FRA require the mandatory physical delivery of the notional principal amount upon maturity.

Which of the statements is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

May/June 2024

74. How is a forward contract defined in the context of foreign exchange derivatives?

- (A) A contract to execute a spot transaction at prevailing market rates on a future date
- (B) A contract giving the buyer the right, but not the obligation, to purchase currency
- (C) A standardized contract traded exclusively on a futures exchange with daily margining
- (D) A contract to deliver foreign currency on a future date at a fixed exchange rate

Oct/Nov 2008

75. Which pair correctly identifies the type of currency swap based on the hedged components?

- (A) COS : Only the currency risk pertaining to the principal amount is hedged
- (B) P+I Swap : Currency risk and interest rate risk are both fully eliminated
- (C) POS : Only the interest rate risk of the underlying loan is actively hedged
- (D) COS : Both principal and interest rate risks are completely hedged by the bank

May/June 2006

76. In the pricing of forward contracts, how does the interest rate differential between two currencies typically manifest?

- (A) The currency with the higher interest rate is quoted at a premium over the spot rate
- (B) The domestic currency is quoted at a

premium regardless of its prevailing interest rate

- (C) The currency with the higher interest rate is quoted at a discount to the spot rate
- (D) Forward premiums and discounts remain independent of the prevailing interest rate differential

Oct/Nov 2017

77. An investor in Germany intends to invest in the Indian market and needs Rupee funds. Simultaneously, an Indian company seeks Euro funds to take over a firm in France. They each raise loans in their respective domestic currencies at lower rates and decide to exchange the loan cash flows. What derivative arrangement serves their respective objectives?

- (A) Currency Swap
- (B) Forward Rate Agreement
- (C) Interest Rate Swap
- (D) Swaption

May/June 2008

78. An exporter executes a 3-month forward sale contract to sell their export proceeds at Rs. 77.00 per USD. On the expiry date, the prevailing spot market rate is Rs. 75.00 per USD. What will be the outcome for the exporter?

- (A) The exporter must sell the USD at Rs. 75.00, incurring a net loss due to Rupee appreciation
- (B) The exporter may choose to ignore the contract and sell USD in the open market at Rs. 75.00
- (C) The contract is cancelled and the bank recovers the Rs. 2.00 per USD difference from the client
- (D) The exporter sells the USD to the bank at Rs. 77.00, eliminating the exchange risk

Oct/Nov 2013

79. When does the fundamental need for a currency swap typically arise for a corporate entity?

- (A) When an entity seeks to convert a floating interest rate to a fixed rate in one currency
- (B) When a loan currency differs from the currency in which the revenue is being generated
- (C) When an entity aims to speculate on daily stock index volatility without acquiring shares
- (D) When an importer takes delivery of foreign

Oct/Nov 2015

29. Consider the following statements regarding the chief uses of derivatives by bank treasuries:
- To manage risk, including Asset Liability Management (ALM) risks.
 - To cater to the requirements of the clients and particularly corporate customers.
 - To eliminate counter-party risk completely in all wholesale lending transactions.
- Which combination of statements is correct?
- I and II only
 - II and III only
 - I and III only
 - I, II and III

May/June 2013

30. Consider the following statements regarding the varieties of interest rate swaps:
- A floating to floating rate swap is also known as a basis swap.
 - Quanto swaps refer to paying interest in home currency at rates applicable to a foreign currency.
 - Swaps with built-in options are known as swaptions.
- Which combination of statements is correct?
- I and II only
 - II and III only
 - I and III only
 - I, II and III

Oct/Nov 2021

31. A corporate client approaches a bank requiring a forward contract to sell USD on a future date. The client wants the contract for a highly specific amount and an unconventional maturity period that precisely matches its cash flows. Which type of derivative product is the bank most likely to offer?
- An exchange-traded and highly standardized future
 - A fixed-income security swap with a standardized tenor
 - A marked-to-market index future traded on the exchange
 - A customized Over-the-Counter (OTC) structured product

May/June 2024

32. Match the Swap Tenor in List I with its corresponding Credit Conversion Factor for Interest Rate Contracts in List II.

List I: (Swap Tenor)

- Up to and including One Year
- Over 1 year to 5 years
- Above 5 years
- Exchange Rate Contracts above 5 years

List II: (Credit Conversion Factor)

- 1.00%
 - 3.00%
 - 0.50%
 - 15.00%
- P-3, Q-1, R-2, S-4
 - P-1, Q-2, R-3, S-4
 - P-3, Q-2, R-1, S-4
 - P-2, Q-1, R-4, S-3

Oct/Nov 2008

33. Consider the following statements regarding counter-party risk in derivatives:
- In OTC products, counter-party risk is present, but it is considered a remote risk for banks.
 - In Exchange Traded products, there is no counter-party risk as the Exchange manages the risk through a margining system.
- Which of the statements is/are correct?
- Only I is correct
 - Only II is correct
 - Both I and II are correct
 - Neither I nor II is correct

May/June 2006

34. A company has a loan with an interest rate linked to an alternate reference rate, due to be fixed on 29th June. Fearing the rate may rise significantly by then, the company wishes to fix the interest rate today for the next 6-month period ending 12 months from now. Which instrument should the company buy?
- A 6/12 FRA
 - A 3/6 IRS
 - A USD Put Option
 - A Constant Maturity Swap

Oct/Nov 2017

35. All of the following are characteristics of a forward contract, EXCEPT:
- It permits the holder to gain from favorable market rate movements
 - It provides protection to an exporter against the appreciation of the domestic currency
 - It necessitates the physical delivery of currency on the expiry date to avoid

- (D) The exchange will cancel the contract due to the adverse rate movement.

May/June 2018

60. Regarding the dissemination of the FBIL Overnight MIBOR rate, consider the following statements:

- I. The standard announcement time is 10.45 AM every day.
- II. If the time is extended due to non-fulfilment of threshold criteria, the dissemination time may get suitably extended.

Which of the statements is/are correct?

- (A) Only I is correct
- (B) Only II is correct
- (C) Both I and II are correct
- (D) Neither I nor II is correct

Oct/Nov 2016

61. All of the following statements regarding interest rate futures are correct, EXCEPT:

- (A) Contracts written on treasury bonds deal in short-term interest rates.
- (B) They are the most popular instruments to hedge interest rate risk.
- (C) Treasury bills are traded at a discount, which is equal to the interest rate for the period.
- (D) If the expected interest rate is 4%, a Treasury bond futures contract will trade at 96.

May/June 2014

62. A corporate client wishes to aggressively hedge its foreign exchange exposure using heavily leveraged exotic derivative products, despite a lack of understanding of the embedded risks. What is the primary responsibility of the bank before offering these products?

- (A) To execute the trade immediately to lock in preferred rates
- (B) To refer the client to the CCIL platform for independent trade
- (C) To convert the exotic product into an exchange traded future
- (D) To verify the client's risk policy and conduct suitability checks

Oct/Nov 2019

63. A corporate expects to borrow USD after 3 months but wishes to lock into the current interest rate today using futures. The corporate decides to short sell a 90-day treasury futures contract. If the interest rates subsequently rise

on the date of availing the loan, how does the hedge perform?

- (A) The rising bond price causes a futures loss that offsets the benefit of lower loan interest
- (B) The bond price remains static while the clearing exchange pays the daily margin difference
- (C) The corporate abandons the futures contract as short selling is not permitted for hedging
- (D) The falling bond price generates a futures profit that offsets the higher loan interest

May/June 2009

64. What is the definition of "Plain Vanilla type Swaps"?

- (A) Currency and interest rate swaps that incorporate barrier and digital options
- (B) Swaps where the principal amount is exchanged daily on a marked-to-market basis
- (C) Basic swaps with simple structure, lacking inbuilt options or knock-out levels
- (D) Interest rate swaps executed exclusively on standardized exchange-traded futures

Oct/Nov 2011

65. What is the primary mechanism of an Interest Rate Swap (IRS)?

- (A) The physical exchange of two principal amounts denominated in different currencies
- (B) The exchange of interest flows on an underlying asset based on a notional principal
- (C) The upfront payment of a premium to guarantee a fixed maximum borrowing rate limit
- (D) The daily marking to market of equity positions against a specific inter-bank rate

May/June 2010

66. Consider the following statements regarding derivative instruments:

- I. Forward contracts are OTC products used to fix exchange rates for purchase or sale of currency.
- II. Futures are standardized products traded on an exchange with definite delivery.
- III. Interest rate swaps shift the basis of interest rate calculation, such as from fixed to floating.
- IV. FRAs are used to fix interest rate for a single

(D) I, II, III, IV

Oct/Nov 2020

41. What fundamental right does an option contract provide to the buyer?
- (A) The legal right and obligation to buy or sell an underlying product at the market price
 - (B) The right to defer physical delivery of an underlying commodity without paying a premium
 - (C) The right to unilaterally alter the strike price of an underlying asset on the expiry date
 - (D) The right but not the obligation to trade an underlying product at a strike price

May/June 2022

42. Consider the following statements regarding the ISDA documentation standard:
- I. The stages are the ISDA Master Agreement, the Schedule to Master Agreement, and the Trade Confirmation.
 - II. Requirements for customisation are incorporated in the Schedule to Master Agreement.
 - III. Specific covenants of each trade are elaborated in the Trade Confirmation.
 - IV. In the event of a dispute, what is stated in the Master Agreement rules superior over the Trade Confirmation.

Which combination of statements is correct?

- (A) I, II and III only
- (B) I, III and IV only
- (C) II, III and IV only
- (D) I, II, III and IV

Oct/Nov 2007

43. Which of the following pairs correctly defines the nature of option contracts?
- (A) Call option : A right given to the holder to sell the underlying product
 - (B) Put option : A right given to the holder to sell the underlying product
 - (C) Put option : A right given to the holder to purchase the underlying product
 - (D) Call option : An obligation placed on the holder to purchase the underlying product

May/June 2019

44. Which of the following represent steps taken to encourage the derivative market while introducing IRS?
- I. Banks have been allowed to use the IRS

not only for hedging, but also for trading (market making).

- II. Use of MIFOR as a benchmark for interest rate swaps.
- III. Banks under ISDA Agreement permitted to opt for dual jurisdiction.
- IV. Prohibiting the use of O/N MIBOR in domestic markets entirely.
- V. Restricting the use of MIFOR only for inter-bank dealings.

Which combination of statements is correct?

- (A) I, II, III and V only
- (B) I, II, IV and V only
- (C) II, III, IV and V only
- (D) I, II, III, IV and V

Oct/Nov 2023

45. A customer purchases a CALL Option on USD. On the start date, the Spot Price of USD is Rs. 75.00 and the Strike Price is set at Rs. 73.00. What is the Intrinsic Value of this CALL Option?
- (A) Rs. 2.00
 - (B) - Rs. 2.00
 - (C) Rs. 74.00
 - (D) Zero

May/June 2005

46. Which of the following statements correctly describes the jurisdictional provision permitted for banks under the ISDA Agreement?
- (A) Banks are restricted to Indian law jurisdiction to prevent cross-border disputes
 - (B) Banks may opt for dual jurisdiction, covering Indian and common law jurisdictions
 - (C) Jurisdiction is determined by the location of the clearing exchange in the deal
 - (D) Global banks must surrender common law jurisdiction before engaging Indian banks

Oct/Nov 2014

47. Consider the following statements regarding option premium components:
- I. Option premium has two components: intrinsic value and time value.
 - II. Intrinsic value can be negative if the option is significantly out-of-the-money.
 - III. Time value is also known as extrinsic value.
 - IV. Time value is maximum for an at-the-money (ATM) option.

Which combination of statements is correct?

- (A) I, II and III only
- (B) I, III and IV only

- (C) II, III and IV only
(D) I, II, III and IV

May/June 2012

48. Regarding the expansion of exchange traded hedging tools in India, which of the following statements are correct?

- I. USD Rupee options were allowed in the Indian market from June 2003.
- II. Banks and corporates can use cross currency options for trading and speculation without any underlying transactions.
- III. Plain vanilla currency options contracts have been permitted to be traded in recognized stock exchanges recognized by SEBI.

Which combination of statements is correct?

- (A) I and II only
(B) I and III only
(C) II and III only
(D) I, II and III

Oct/Nov 2009

49. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): Traders and speculators do not require large investments to trade in options.

Reason (R): The price of an option is much smaller than the notional value, allowing for high leverage.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2025

50. AD Category - I banks that do not meet the minimum prudential requirements, as well as Urban Co-operative banks and State Co-operative banks, are restricted in the exchange traded currency options market. Under what capacity are they exclusively permitted to participate?

- (A) As clients only
(B) As market makers
(C) As clearing members only

- (D) As independent exchange administrators

Oct/Nov 2022

51. An Indian exporter wishes to mitigate the risk of Rupee appreciation, while an Indian importer wants to protect against Rupee depreciation. If a bank acts as an intermediary to facilitate this risk mitigation through options, what positions will the bank take?

- (A) The bank sells a USD put option to the exporter and sells a USD call option to the importer.
(B) The bank buys a USD call option from the exporter and buys a USD put option from the importer.
(C) The bank sells a USD call option to the exporter and sells a USD put option to the importer.
(D) The bank buys a USD put option from the exporter and sells a USD put option to the importer.

May/June 2016

52. Consider the following statements regarding regulatory guidelines on risk management and derivative products:

- I. Derivative products can be offered only to corporates who have a clearly laid down risk management policy approved at the Board level.
- II. Banks must have a suitability and appropriateness policy to avoid mis-selling.
- III. All complex exotic derivative structures were entirely banned for all entities, including banks.
- IV. Guidelines were issued following significant corporate losses on aggressively marketed structured products.

Which combination of statements is correct?

- (A) I, II and III only
(B) I, II and IV only
(C) II, III and IV only
(D) I, II, III and IV

Oct/Nov 2018

53. A corporate client requires an option structure that eliminates the upfront premium payment entirely, but is willing to accept a corresponding risk of paying a higher rate if the market rate rises beyond a specified level. Which structured product meets this requirement?

- (A) A Range Forward

- (B) A Plain Vanilla Option
- (C) A Barrier Option
- (D) An In-The-Money Call Option

May/June 2023

- 54.** The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): Interest Rate Options (IRO) were introduced in the Indian market with effect from 31st January 2017.

Reason (R): Eligible market participants needed instruments to take positions for their own balance sheet management and for market making purposes.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2006

- 55.** A bank issues a Perpetual Debt Instrument (PDI) to raise capital. To provide itself with the flexibility to prepay the debt on a specified future date, subject to stipulated terms and conditions, the bank should issue the PDI with which type of embedded feature?
- (A) A convertible option
 - (B) A call option
 - (C) A put option
 - (D) A plain vanilla interest rate swap

May/June 2021

- 56.** Which of the following pairs concerning the roles of institutions in the Indian derivative market is incorrectly matched?
- (A) FIMMDA : Publishes a list of rupee money or debt market rates used as underlying for Interest Rate Options
 - (B) FBIL : Administers benchmarks relating to money market, government securities, and foreign exchange
 - (C) FEDAI : Solely responsible for approving capital adequacy norms for bank treasuries
 - (D) CCIL : Acts as the Calculating Agent for the Overnight MIBOR benchmark rate

Oct/Nov 2010

- 57.** Consider the following statements highlighting the differences between futures contracts and forward contracts:

- I. In futures, the buyer and seller deal directly with each other without an intermediary.
- II. Futures contracts are marked-to-market daily.
- III. Losses in futures are recovered from the holder by way of margin.
- IV. Futures contracts are actively traded and can be bought and sold several times during the day.

Which combination of statements is correct?

- (A) I, II and III only
- (B) I, III and IV only
- (C) II, III and IV only
- (D) I, II, III and IV

May/June 2007

- 58.** Consider the following statements regarding the objectives and operational framework of FBIL:

- I. It is an independent company.
- II. It is responsible for collection and submission of market data including polled data.
- III. It ensures benchmarks are free from bias and backed by robust data driven research.
- IV. It calculates the O/N MIBOR based strictly on projected future interest rates.
- V. It aims to develop and administer benchmarks compliant with global best practices.

Which combination of statements is correct?

- (A) I, II, III and V only
- (B) II, III, IV and V only
- (C) I, III, IV and V only
- (D) I, II, III, IV and V

Oct/Nov 2025

- 59.** An investor trades a futures contract of GBP 25,000 at the LIFFE for delivery on 28th March at a contracted rate of USD 1.3700 per GBP. On the settlement date, the market rate of GBP is USD 1.4000 per GBP. What will be the settlement mechanism for this contract?

- (A) The buyer will pay the seller USD 0.03 per Pound.
- (B) The seller will pay the buyer USD 0.03 per Pound.
- (C) The contract will be physical delivery only, exchanging GBP 25,000 for USD 35,000.

NODIA

- (A) 1-week
- (B) 1-month
- (C) 9-month
- (D) 12-month

May/June 2009

22. What is the fundamental financial relationship upon which an interest rate futures hedge is based?
- (A) A direct proportional relationship between interest rates and bond prices.
 - (B) A direct correlation between equity indices and commodity futures.
 - (C) An inverse relationship between interest rates and bond prices.
 - (D) An inverse relationship between spot exchange rates and forward premiums.

Oct/Nov 2011

23. Match the Keywords in List I with their respective definitions in List II.

List I: (Keywords)

- P. Hedge
- Q. Embedded Options
- R. ARR
- S. Margin

List II: (Definitions)

- 1. Alternate Reference rate
- 2. Protection of risk in a transaction, usually obtained from derivative products
- 3. Options inbuilt in a product, e.g., a bond with put option
- 4. A portion of underlying principal amount maintained as security for credit risk

- (A) P-2, Q-3, R-1, S-4
- (B) P-3, Q-2, R-4, S-1
- (C) P-1, Q-4, R-3, S-2
- (D) P-4, Q-1, R-2, S-3

May/June 2010

24. When hedging an underlying exposure fully using standardized futures contracts, an exporter needs to hedge receivables of USD 560,700 by purchasing 561 forward sale contracts of USD 1000 each. What does the difference between the face value of the contracts and the exposure constitute?
- (A) Intrinsic value
 - (B) Opportunity cost
 - (C) Basis risk
 - (D) Time value

Oct/Nov 2024

25. Which of the following statements is false regarding derivative instruments?
- (A) Forwards, options, futures and swaps are available for trading/hedging currency and interest rate risks.
 - (B) Bank treasuries are mostly concerned with OTC products based on financial markets.
 - (C) Options offer a right to buy or sell an underlying product without any obligation to exercise the contract.
 - (D) Unlike options, futures do not have a definite delivery.

May/June 2017

26. A company paying a fixed rate of 7% on its 5-year debenture enters into a swap to exchange this fixed rate with a floating rate of T-bill + 2%. Every three months, the bank pays the company 7%, and the company pays the bank T-bill + 2%. If the 90-day T-bill rate next quarter is 4%, what is the net saving to the company reflecting the fall in the market rate?
- (A) 1%
 - (B) 2%
 - (C) 3%
 - (D) 4%

Oct/Nov 2005

27. Which of the following statements regarding the Indian derivative market is incorrect?
- (A) Regulations permit the use of derivatives including IRS and USD/Rupee options subject to certain restrictions.
 - (B) Interest rate futures are the most highly liquid and deeply developed derivative market in India.
 - (C) Common benchmarks for interest rate swaps include SOFR for USD and O/N MIBOR for Rupee borrowings.
 - (D) USD/INR contracts are actively traded on the futures market of NSE and MCX-SX.

May/June 2020

28. In the context of international benchmark rates, the LIBOR has been phased out. Which alternate reference rate has replaced it for USD?
- (A) Overnight Mumbai Inter-bank Offered Rate
 - (B) Indian Benchmark Rate (INBMK)
 - (C) Secured Overnight Financing Rate (SOFR)
 - (D) Mumbai Inter-bank Forward Outright Rate

interest payment period.

- V. Currency swaps only hedge exchange rate risk, while leaving interest rate risk entirely unhedged.

Which combination of statements is correct?

- (A) I, II, III and IV only
(B) II, III, IV and V only
(C) I, III, IV and V only
(D) I, II, III, IV and V

Oct/Nov 2024

67. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): In an interest rate swap, the actual notional principal amount is never exchanged between the bank and the company.

Reason (R): The interest rates are calculated on the notional amount, and actual payment of the interest is netted out on the interest payment date.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2017

68. What defines a derivative?
- (A) A standardized financial contract possessing an independent, intrinsic market value
(B) A contract deriving value from an underlying asset, based on a notional amount
(C) A cash market product that guarantees immediate physical delivery of specific commodities
(D) An underlying market index determining the spot price of foreign exchange and equities

Oct/Nov 2005

69. What makes the MIFOR benchmark rate particularly suitable for specific types of transactions?
- (A) A mix of alternate reference rates and USD/INR forward premiums for swapped borrowings

- (B) A benchmark based on overnight Mumbai inter-bank rates ideal for domestic short-term loans
(C) A rate relying on the yield of G-secs, specifically designed for Constant Maturity Swaps
(D) An exchange-traded index used to hedge physical commodity deliveries across global markets

May/June 2020

70. Which of the following statements regarding the reporting of inter-bank derivative trades is incorrect?

- (A) All inter-bank OTC foreign exchange derivative trades must be reported
(B) Corporates must directly report selective OTC trades on the NSE platform
(C) Most derivative trades are reported to the CCIL platform for surveillance
(D) Reporting follows a confidentiality protocol among representative market bodies

Oct/Nov 2015

71. The Treasury department of a Bank notices an asset-liability mismatch where long-term fixed-rate assets are funded by short-term floating-rate liabilities. To bridge this internal requirement and manage the interest rate risk, which derivative instrument should the Treasury predominantly use?

- (A) Principal Only Currency Swap (POS)
(B) Interest Rate Swap (IRS)
(C) Plain Vanilla Equity Option
(D) Commodity Futures

May/June 2013

72. Match the concepts in List I with their descriptions in List II.

List I: (Concepts)

- P. Opportunity Cost
Q. Exchange Traded Product
R. Intrinsic Value
S. Over-the-Counter Product

List II: (Descriptions)

- Transparent pricing based on screen-based order matching
- Settlement mostly by physical delivery
- Disadvantage of a forward contract if market rate becomes favorable
- The amount by which an option is In-The-Money

cancellation

- (D) It can be utilized to hedge currency risks in various cross-currency commercial deals

May/June 2008

36. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): Historically, lenders and borrowers enter into currency swaps to derive the benefits of interest rate arbitrage, yet there is no arbitrage between major currencies.

Reason (R): A swap is a series of currency forwards and interest rate forwards, meaning the swap cost directly represents the interest rate differential of the currencies.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2013

37. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): The forward exchange rate of USD/INR is not always exactly equal to the difference between the risk-free interest rates of the two currencies.

Reason (R): The Rupee is not yet fully convertible, causing the forward exchange rate to also be affected by perceptions about supply and demand for forward dollars.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

May/June 2015

38. Consider the following statements regarding variants of currency swaps:

- I. In a Principal Only Swap (POS), the borrower uses the principal amount in home currency without exchange risk.
- II. In a Coupon Only Swap (COS), the USD loan interest is swapped into Rupee interest, but principal repayment is as per original terms.
- III. In a P+I swap, the borrower retains the currency risk on the principal but eliminates the interest rate risk.

Which combination of statements is correct?

- (A) I and II only
 (B) II and III only
 (C) I and III only
 (D) I, II and III

Oct/Nov 2012

39. When a bank grants a 'forward option' facility allowing a client to take delivery within a month before the expiry date, how is the forward premium or discount applied?

- (A) The bank applies a simple arithmetic average of the spot rate and the 1-month forward rate
 (B) The bank quotes the rate for the start or end date, whichever is least favorable to the client
 (C) The bank strictly applies the forward rate corresponding to the specific date delivery is taken
 (D) The bank waives the premium or discount because the exact delivery timing is legally uncertain

May/June 2011

40. Arrange the following developments in Indian derivative markets in their correct chronological order:

- I. USD Rupee options allowed in the Indian market.
- II. Interest rate swaps (IRS) and forward rate agreements (FRA) first allowed.
- III. Conventional forward contracts in foreign exchange were the only available derivative product.
- IV. Futures market for USD/INR commenced.

- (A) III, II, I, IV
 (B) III, I, II, IV
 (C) II, III, I, IV

currency a month before the contract expiration

May/June 2015

80. Which of the following statements correctly describes the relationship between USD and EURO forward rates?
- (A) Because the interest rate of EURO is lower than that of USD, forward EURO is at a discount to USD.
 - (B) Because the interest rate of USD is higher than that of EURO, forward EURO is at a premium to USD.
 - (C) Because the interest rate of EURO is higher than that of USD, forward EURO is at a discount to USD.
 - (D) The forward EURO rate is determined exclusively by the supply of USD, regardless of interest rates.

NODIA

over-the-counter products are customized agreements where settlement often involves the physical delivery of the underlying asset.

73. (A) Only I is correct

Interest rate swaps and forward rate agreements are both used to manage interest rate risk without exchanging the principal amount. The primary difference lies in their scope; a swap involves a series of interest payments over a long period, whereas a forward rate agreement is designed for a single interest payment on a specific future date. Both are cash-settled instruments.

74. (D) A contract to deliver foreign currency on a future date at a fixed exchange rate

A forward contract is a fundamental foreign exchange derivative used to mitigate currency risk. It is a legally binding agreement between a bank and its client to buy or sell a specific amount of foreign currency at a fixed exchange rate on a predetermined future date. This allows businesses to lock in their costs and avoid the uncertainty of market fluctuations.

75. (B) P+I Swap : Currency risk and interest rate risk are both fully eliminated

Currency swaps are designed to manage different components of foreign currency debt. A Principal plus Interest swap is a comprehensive instrument that eliminates both the exchange rate risk associated with the principal repayment and the interest rate risk of the coupons. This provides the borrower with complete certainty in their domestic currency, covering all cash flows associated with the foreign loan.

76. (C) The currency with the higher interest rate is quoted at a discount to the spot rate

The pricing of forward contracts is primarily driven by the interest rate parity theory. According to this principle, the currency belonging to the country with higher interest rates will typically trade at a discount in the forward market. Conversely, the currency with lower interest rates will be quoted at a premium, ensuring that there are no simple arbitrage opportunities between currencies.

77. (A) Currency Swap

A currency swap is an ideal arrangement for parties in different countries who have a

comparative advantage in their own domestic debt markets. By raising loans locally and then exchanging the principal and interest cash flows, both parties can obtain their desired foreign currency at a lower total cost than if they had borrowed that foreign currency directly from the start.

78. (D) The exporter sells the USD to the bank at Rs. 77.00, eliminating the exchange risk

A forward sale contract is a mandatory agreement that fixes the exchange rate for a future transaction. If an exporter has contracted to sell dollars at seventy-seven rupees, they must fulfill this obligation regardless of the current market rate. If the spot rate falls to seventy-five, the exporter benefits by receiving the higher contracted rate from the bank for their proceeds.

79. (B) When a loan currency differs from the currency in which the revenue is being generated

Corporate entities often require currency swaps when they face a mismatch between their debt obligations and their income. This occurs if a company borrows in a foreign currency but earns its revenue in its domestic currency. A swap allows the entity to convert its foreign currency liability into a domestic one, effectively hedging against the risk of the domestic currency weakening.

80. (C) Because the interest rate of EURO is higher than that of USD, forward EURO is at a discount to USD.

Forward exchange rates are largely influenced by the interest rate differentials between two currencies. When the interest rate of a currency like the Euro is higher than that of the US Dollar, the Euro will be quoted at a forward discount relative to the Dollar. This adjustment reflects the market's alignment of total returns across different currency-denominated investments and debt instruments.

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STAY ONE STEP AHEAD.

9. (A) I, II, III and IV only

To ensure stability in the exchange-traded currency options market, Authorised Dealer Category-I banks must satisfy specific prudential norms. These include maintaining a net worth of at least five hundred crore rupees and a minimum capital to risk-weighted assets ratio of ten percent. Additionally, banks must have a low net non-performing asset ratio and consistent profitability over three years.

10. (A) I, II, III and IV only

Several market variables determine the cost of an option premium. These include the volatility of the underlying asset, the time remaining until the expiry date, and prevailing interest rates. Additionally, the strike price relative to the current market price significantly impacts the value. The credit rating of the buyer does not affect the premium, as the buyer pays upfront.

11. (B) The limit is Rs. 120 crores, being the higher of the two listed parameters

Exporters can hedge currency risks through exchange-traded derivatives on a declaration basis. The eligible limit for such transactions is determined by looking at the average export turnover from the previous three years or the turnover from the immediately preceding year. Regulators allow the higher of these two figures to serve as the maximum position the exporter can take.

12. (C) A call option on a stock index offers protection against a fall in the index.

Stock options provide the right to buy or sell equity shares or indices at a predetermined strike price. A call option specifically protects the holder against a rise in the index or share price. Suggesting that a call option offers protection against a fall is incorrect, as put options are the instruments used to hedge against declining market values.

13. (A) Residents and FPIs need underlying exposure to trade in cross currency contracts

Current regulations regarding cross-currency contracts allow residents and Foreign Portfolio Investors to participate in these markets under specific conditions. While many transactions require proof of underlying exposure, certain limits and contract types do not necessitate a

documented underlying. This flexibility supports market liquidity and allows participants to manage global currency risks more effectively without always proving a physical trade.

14. (A) P-3, Q-1, R-4, S-2

Forward contracts require execution at a specific rate on maturity, with pricing typically including a bank margin rather than an upfront fee. In contrast, option contracts grant the holder a right without any obligation to trade. Options involve an upfront premium payment, which represents the cost of acquiring this flexibility, distinguishing them from the mandatory nature of forwards.

15. (D) European options exercisable only at the expiration date of the contract

Interest Rate Options in the Indian financial market are designed to help entities manage fluctuations in borrowing and lending rates. According to the regulatory guidelines, these permitted options follow the European style. This means that the holder can only exercise the right to buy or sell the underlying interest rate instrument on the specific expiration date of the contract.

16. (C) Standardized forward contracts traded on an exchange with prefixed settlement dates

Futures are specialized financial instruments that represent standardized forward contracts. Unlike customized over-the-counter agreements, futures are traded on organized exchanges and feature fixed expiration dates and contract sizes. They are subject to daily marking-to-market and margin requirements, ensuring high liquidity and transparency for participants looking to hedge or speculate on future price movements of various assets.

17. (A) I, II, III

The establishment of Financial Benchmarks India Private Limited involved a sequence of legal and operational steps. First, the Companies Act was enacted, providing the legal framework for its registration. Subsequently, the company was formally incorporated as a private limited entity. Finally, it began its operations by publishing benchmarks such as the Overnight Mumbai Inter-bank Offered Rate for the market.

remain an efficient mechanism for converting debt from one currency to another.

- 37.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

In an ideal market, forward exchange rates are determined by interest rate differentials. However, for the US Dollar and Indian Rupee, the forward rate is also influenced by the supply and demand for forward dollars. This is because the Rupee is not fully convertible, meaning that market perceptions and capital flow restrictions can cause deviations from the theoretical interest parity.

- 38.** (A) I and II only

Currency swaps offer various ways to hedge loan exposures. A Principal Only Swap protects the borrower against exchange rate changes affecting the principal amount. Similarly, a Coupon Only Swap manages the currency risk associated with interest payments while leaving the principal as originally denominated. These variants allow companies to selectively hedge specific parts of their foreign currency debt obligations.

- 39.** (B) The bank quotes the rate for the start or end date, whichever is least favorable to the client
A forward option facility provides a client with a window of time to take delivery of currency. To compensate for this flexibility and the uncertainty of the exact delivery date, the bank applies the most conservative pricing. This means the bank quotes the specific forward rate from the start or end of the period that is least advantageous to the client.

- 40.** (A) III, II, I, IV

The evolution of the Indian derivative market followed a structured timeline. Initially, traditional forward contracts were the only tool available for managing foreign exchange risk. Over time, regulators permitted interest rate swaps and forward rate agreements in 1999, followed by currency options in 2003. Finally, the market for currency futures was launched in 2008 to provide exchange-traded hedging options.

- 41.** (D) The right but not the obligation to trade an underlying product at a strike price

An option contract is a unique financial agreement that offers the purchaser a specific privilege. This privilege consists of the right to buy or sell an underlying asset at a predetermined price, known as the strike price. Crucially, the buyer is under no obligation to execute the trade if the market conditions are unfavorable on the expiry date.

- 42.** (A) I, II and III only

The ISDA documentation standard involves a hierarchical structure consisting of the Master Agreement, its Schedule, and individual Trade Confirmations. While the Master Agreement and Schedule provide the general legal framework and customized terms, the Trade Confirmation records the specific details of each transaction. However, the specific terms in the Confirmation actually take precedence over the Master Agreement in disputes.

- 43.** (B) Put option : A right given to the holder to sell the underlying product

Option contracts are categorized based on the specific right they grant to the holder. A call option gives the holder the right to purchase an underlying asset at a set price. Conversely, a put option provides the right to sell the underlying asset. These instruments allow participants to hedge against price increases or decreases without being forced to trade.

- 44.** (A) I, II, III and V only

To foster a robust derivative market, regulators allowed banks to use interest rate swaps for both hedging and market making. The introduction of benchmarks like the Mumbai Inter-bank Forward Offered Rate and the provision for dual jurisdiction under ISDA agreements further supported market growth. These steps ensured that banks had the flexibility and legal clarity to manage complex interest rate risks.

- 45.** (A) Rs. 2.00

The intrinsic value of a call option represents the immediate profit if the option were exercised at the current spot price. It is calculated by subtracting the strike price from the spot price. In this scenario, with a spot price of seventy-five and a strike price of seventy-three, the option

challenges. Compared to other instruments, interest rate futures are not considered the most highly liquid or deeply developed segment of the Indian market. Regulations continue to evolve to improve participation and liquidity for these specific exchange-traded debt instruments.

- 28. (C) Secured Overnight Financing Rate (SOFR)**
Following the global transition away from the London Inter-bank Offered Rate, the Secured Overnight Financing Rate has emerged as the primary alternate reference rate for US Dollar transactions. This rate is based on actual transactions in the Treasury repurchase market, providing a more robust and transparent benchmark than the previously used estimates for international lending and derivatives.
- 29. (A) I and II only**
Bank treasuries utilize derivatives primarily for two reasons. First, they manage internal risks, such as mismatches between assets and liabilities. Second, they provide products to corporate clients needing to hedge their own market exposures. While these instruments manage risks, they do not completely eliminate counter-party risk in wholesale lending, as the derivatives themselves carry their own default risks.
- 30. (D) I, II and III**
Interest rate swaps come in several varieties to meet diverse financial needs. Basis swaps involve exchanging two different floating rates, while Quanto swaps calculate interest in one currency but pay in another. Additionally, swaptions give the holder the right to enter into a swap agreement later. These variants allow entities to customize their interest rate risk management strategies effectively.
- 31. (D) A customized Over-the-Counter (OTC) structured product**
Corporate clients often have unique cash flow requirements that do not align with the standardized terms of exchange-traded products. For such specific needs, banks offer customized over-the-counter products. These structured derivatives are negotiated directly between the bank and the client, allowing for flexibility in amounts, maturity dates, and settlement terms that precisely match the underlying commercial exposure.

- 32. (A) P-3, Q-1, R-2, S-4**
Credit conversion factors are used to determine the credit risk of derivative contracts based on their tenor. For interest rate contracts, the factor is zero point five percent for tenors up to one year and one percent for those between one and five years. Longer tenors and exchange rate contracts attract higher factors, such as fifteen percent for long-term currency deals.
- 33. (C) Both I and II are correct**
Counter-party risk is a significant consideration in derivative trading. In over-the-counter products, this risk exists because one party might default on their obligation. In contrast, exchange-traded products use a clearinghouse and a rigorous margining system to manage and virtually eliminate this risk for participants. Both statements accurately reflect how the market structure influences the level of credit risk.
- 34. (A) A 6/12 FRA**
A Forward Rate Agreement is a contract used to lock in an interest rate for a specific future period. A six-by-twelve agreement allows a company to fix the rate for a six-month duration that starts six months from the current date. This instrument is ideal for borrowers who fear rising interest rates and want to ensure cost certainty.
- 35. (A) It permits the holder to gain from favorable market rate movements**
Forward contracts are binding agreements to trade at a set price, providing protection against adverse currency movements like appreciation or depreciation. However, because they are mandatory, they prevent the holder from benefiting if the market rate moves in their favor. This lack of participation in favorable market changes is a key characteristic that distinguishes forwards from option contracts.
- 36. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).**
Currency swaps are often used by lenders and borrowers to achieve lower financing costs through interest rate differentials between currencies. Technically, a swap consists of a series of forward contracts, making the cost reflect the gap between interest rates. While major currencies show minimal arbitrage opportunities, swaps

ANSWERS

NODIA

1. (A) Only I is correct
Banks and counterparties use a master agreement to provide a legal framework for multiple derivative transactions. This document eliminates the need to renegotiate legal terms for every individual trade. By executing this single agreement, parties streamline the documentation process, ensuring that subsequent deals are governed by the same overarching terms while only specific trade details are confirmed.
2. (A) American type option
Regulators in the Indian over-the-counter derivative market implemented restrictions on American style options following the 2008-2009 global financial crisis. These instruments allow exercise at any point before expiry, which created complex risk management challenges during volatile periods. Consequently, the market moved towards European style options, which are more predictable as they are only exercisable at maturity.
3. (A) The Trade Confirmation
Under the standard ISDA documentation framework, the relationship between the Master Agreement, its Schedule, and individual confirmations is clearly defined. While the Master Agreement provides general terms, the Trade Confirmation contains the specific details of a particular transaction. In the event of a conflict or dispute regarding a specific trade, the terms specified in the Confirmation prevail over others.
4. (B) Decline to exercise, as more yen per dollar is available in the open market
An investor holding a put option has the right to sell the underlying asset at a fixed price. Since the market price of 108 yen per dollar is higher than the strike price of 105 yen, the investor can receive more yen by selling dollars in the open market. Therefore, declining to exercise the option is the only rational financial action.
5. (A) CCIL
The Mumbai Inter-bank Forward Offered Rate is a benchmark used in the Indian interest rate swap market. Financial Benchmarks India Private Limited oversees the methodology and administration of this rate. The Clearing Corporation of India Limited serves as the calculating agent, processing the necessary data from the foreign exchange and money markets to determine the daily benchmark rate.
6. (A) P-4, Q-2, R-3, S-1
Moneyness describes the relationship between an option strike price and the current market rate. An at-the-money call has a strike equal to the forward rate. For in-the-money options, a call strike is below the forward rate, while a put strike is above it. Conversely, an out-of-the-money put has a strike price lower than the current forward rate.
7. (B) Corporates must directly report selective OTC trades on the NSE platform
Reporting requirements for over-the-counter derivative trades are strictly regulated to ensure transparency and surveillance. While inter-bank trades are reported to platforms like the Clearing Corporation of India, corporates are not required to report their selective trades directly on the stock exchange platforms. Instead, reporting is typically handled by the banks acting as intermediaries for their corporate clients.
8. (C) The buyer's risk is limited to the premium, while the seller faces unlimited loss
The risk profiles of option participants are asymmetric. A buyer pays a premium to acquire the right to trade, meaning their maximum potential loss is strictly limited to that upfront payment. In contrast, the seller receives the premium but assumes the obligation to perform if the buyer exercises, potentially facing unlimited losses if the market moves significantly against them.

is in-the-money with an intrinsic value of two rupees.

- 46.** (B) Banks may opt for dual jurisdiction, covering Indian and common law jurisdictions
Under the ISDA Agreement, banks are afforded flexibility regarding the legal jurisdiction that governs their derivative transactions. They are permitted to opt for dual jurisdiction, which typically includes both Indian law and English common law. This arrangement facilitates international trading by ensuring that the contracts are enforceable and understood across different legal systems and global financial hubs.
- 47.** (B) I, III and IV only
An option premium consists of intrinsic value and time value. Intrinsic value is the difference between the strike and spot prices but cannot drop below zero. Time value, also called extrinsic value, represents the potential for the option to become more profitable before expiry. This time value is generally highest when the option is at-the-money, meaning the prices are equal.
- 48.** (B) I and III only
The Indian exchange-traded hedging landscape has evolved significantly. Regulators introduced US Dollar and Rupee options in 2003 to provide additional risk management tools. Furthermore, plain vanilla currency options are now traded on recognized stock exchanges. However, participation generally requires an underlying exposure, meaning banks and corporates cannot typically use these instruments for pure speculation or trading without any commercial basis.
- 49.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Options are attractive to traders and speculators because they offer significant leverage. Unlike purchasing the underlying asset, which requires a large capital outlay, an option only requires the payment of a relatively small premium. This premium is a fraction of the total notional value, allowing participants to gain exposure to large market movements with a much smaller initial investment.

- 50.** (A) As clients only
Certain financial institutions, including Urban and State Co-operative banks and Authorised Dealer banks that do not meet specific prudential criteria, face restrictions. These entities are not permitted to act as market makers or clearing members in the exchange-traded currency options market. Instead, they are only allowed to participate in the capacity of clients to hedge their own exposures.
- 51.** (A) The bank sells a USD put option to the exporter and sells a USD call option to the importer.
In a risk mitigation scenario, a bank facilitates the needs of both exporters and importers. An exporter fearing currency appreciation needs a put option to sell currency at a set rate. Conversely, an importer fearing depreciation needs a call option to buy currency. The bank acts as the seller of these options, providing both parties with the necessary protection.
- 52.** (B) I, II and IV only
Regulatory guidelines for derivative products emphasize transparency and risk management. Banks must ensure that corporate clients have board-approved risk policies and must perform suitability checks to prevent mis-selling. These rules were strengthened following significant losses experienced by companies using complex structured products. While structures are regulated, they were not entirely banned for all entities, provided proper safeguards are maintained.
- 53.** (A) A Range Forward
A range forward is a structured product designed to provide a hedge without an upfront premium. It combines the purchase of one option with the sale of another, creating a range within which the exchange rate is locked. This structure is attractive for clients who want to avoid the cost of a premium while accepting a cap on potential gains.
- 54.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Interest Rate Options were introduced to the Indian market in early 2017 to provide participants with flexible tools for managing debt portfolios. These instruments allow banks and

18. (A) Last quarter of 2009

The Indian derivative market expanded its offerings by introducing cross-currency futures contracts. These instruments allowed participants to trade currency pairs like the Euro, British Pound, and Japanese Yen against the Indian Rupee. This specific development commenced during the final quarter of 2009, providing more sophisticated hedging tools for businesses and investors dealing with currencies other than the US Dollar.

19. (B) II, III and IV only

The benchmark Overnight Mumbai Inter-bank Offered Rate is published daily by Financial Benchmarks India Private Limited. It is derived from actual call money transaction data sourced from the NDS-Call platform. The rate is typically announced at ten forty-five in the morning. However, this benchmark is not published on Saturdays, Sundays, or holidays when the call money market is closed.

20. (C) I and III only

Currency futures in the Indian market are traded in standardized lot sizes. For the US Dollar and the Euro, each contract represents one thousand units of the respective currency. However, the Japanese Yen contract is based on a larger volume of one hundred thousand units. Therefore, the statement regarding the Japanese Yen having a thousand-unit contract size is incorrect.

21. (C) 9-month

Financial Benchmarks India Private Limited provides volatility matrices for currency options across various tenors to assist in market pricing. These tenors typically include standard intervals such as one week, one month, and twelve months to cover short and long-term horizons. However, a nine-month tenor is not among the standard periods for which these specific benchmark volatilities are announced.

22. (C) An inverse relationship between interest rates and bond prices.

Interest rate futures serve as a critical tool for hedging against fluctuations in borrowing costs. The effectiveness of this hedge relies on the fundamental inverse relationship between market interest rates and bond prices. When interest rates rise, the value of fixed-income

securities falls, allowing a participant with a short position in futures to offset increased interest expenses with profits.

23. (A) P-2, Q-3, R-1, S-4

Hedging involves using derivatives to protect against financial risks, while embedded options are features like put or call rights integrated into other products like bonds. The Alternate Reference Rate serves as a benchmark for pricing, and margins are security deposits held to mitigate credit risk. Together, these elements form the basis for managing complex financial transactions and risks.

24. (C) Basis risk

When using standardized futures to hedge a specific exposure, the contract sizes may not perfectly match the underlying amount. The resulting discrepancy between the total face value of the futures contracts and the actual exposure leads to basis risk. This risk arises because the hedge is not perfectly aligned with the exact amount or timing of the underlying transaction.

25. (D) Unlike options, futures do not have a definite delivery.

Derivatives such as forwards, options, and swaps are essential for managing currency and interest rate risks. While options provide a choice without obligation, futures are standardized exchange-traded contracts. Unlike the common perception of forwards, most futures contracts are closed out or cash-settled before maturity, meaning they do not typically result in the actual physical delivery of the underlying.

26. (A) 1%

The company swapped a seven percent fixed rate for a floating rate of Treasury bill plus two percent. If the Treasury bill rate drops to four percent, the total floating payment becomes six percent. Compared to the original seven percent fixed liability, the company effectively reduces its interest cost by one percent, demonstrating the benefit of switching to floating rates.

27. (B) Interest rate futures are the most highly liquid and deeply developed derivative market in India.

While India has various derivative products like interest rate swaps and currency options, the interest rate futures market has historically faced

position holder. This profit then compensates the borrower for the higher interest expenses they will incur on their actual underlying loan.

- 64.** (C) Basic swaps with simple structure, lacking inbuilt options or knock-out levels

Plain vanilla swaps represent the most basic form of swap agreements in the financial markets. These contracts feature a simple structure without any complex add-ons like barrier levels, knock-out features, or embedded options. They are used by entities to exchange straightforward cash flows, such as converting a fixed interest rate liability into a floating rate one, or vice versa.

- 65.** (B) The exchange of interest flows on an underlying asset based on a notional principal
An Interest Rate Swap is a derivative contract where two parties exchange periodic interest rate payments based on a specified notional principal. Typically, one party pays a fixed rate while the other pays a floating rate. It is important to note that the principal amount itself is never physically exchanged; it only serves as the basis for calculating the interest flows.

- 66.** (A) I, II, III and IV only
Derivative instruments like forwards and futures serve different market needs. Forwards are customized over-the-counter contracts, whereas futures are standardized and exchange-traded. Interest rate swaps allow for changing the basis of interest payments, and forward rate agreements fix rates for a single period. However, currency swaps are comprehensive tools that can hedge both exchange rate risk and interest rate risk simultaneously.

- 67.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

In interest rate swap transactions, the exchange of the actual notional principal is avoided to simplify the process and reduce credit risk. Instead, the parties calculate their respective interest obligations based on that notional amount. On the payment date, the two interest amounts are netted against each other, and only the resulting difference is paid by one party to the other.

- 68.** (B) A contract deriving value from an underlying asset, based on a notional amount

A derivative is a financial contract that does not have its own inherent value. Instead, its price is derived from the performance of an underlying asset, such as a stock, bond, commodity, or currency. These contracts are typically based on a notional amount, which determines the scale of the price movements and the eventual settlement between the involved parties.

- 69.** (A) A mix of alternate reference rates and USD/INR forward premiums for swapped borrowings
The Mumbai Inter-bank Forward Offered Rate is a specialized benchmark used predominantly in the Indian derivatives market. It is calculated by combining an alternate reference rate with the forward premium for the US Dollar and Indian Rupee. This makes it a particularly effective benchmark for pricing and hedging interest rate swaps related to foreign currency borrowings that have been swapped.

- 70.** (C) Financial market : Rainfall and weather
Derivative products are categorized based on the underlying market they are linked to. Financial markets involve assets like foreign exchange and bonds, while commodity markets deal with physical goods like gold and oil. However, weather-related variables like rainfall do not fall under the standard definition of a financial market product, as they are not financial instruments in the traditional sense.

- 71.** (B) Interest Rate Swap (IRS)
Bank treasuries often face interest rate risk due to assets and liabilities having different interest rate structures. For example, if long-term fixed-rate assets are funded by short-term floating-rate liabilities, a bank is vulnerable to rising rates. An interest rate swap allows the bank to manage this risk by exchanging its floating-rate payments for fixed-rate ones, thereby matching its cash flows.

- 72.** (A) P-3, Q-1, R-4, S-2
Several concepts define the derivative landscape. Opportunity cost refers to the potential gain lost when a fixed forward contract prevents participation in favorable market moves. Exchange-traded products offer transparency and screen-based pricing. Intrinsic value measures how much an option is in-the-money. Finally,

other eligible entities to hedge against interest rate fluctuations or engage in market making. The move was driven by the need for more sophisticated instruments to manage balance sheet risks in the economy.

55. (B) A call option

When a bank issues a Perpetual Debt Instrument, it may include an embedded feature to manage its long-term liabilities. A call option gives the bank the right to repay the debt before the final maturity date under specified conditions. This provides the issuer with flexibility to refinance the debt if market conditions or interest rates become more favorable later.

56. (C) FEDAI : Solely responsible for approving capital adequacy norms for bank treasuries

Institutions like FIMMDA and FBIL play vital roles in administering benchmarks and market rates in India. While CCIL serves as the calculating agent for various benchmarks, the Foreign Exchange Dealers' Association of India focuses on rules for foreign exchange dealings. However, FEDAI is not responsible for setting capital adequacy norms for bank treasuries, as that authority rests with the central bank.

57. (C) II, III and IV only

Futures contracts differ from forwards in several key ways. They are standardized and traded on exchanges rather than directly between parties. Futures are subject to daily marking-to-market, where profits and losses are settled every day through a margin system. Additionally, they offer high liquidity, allowing participants to buy and sell contracts multiple times before they reach the settlement date.

58. (A) I, II, III and V only

Financial Benchmarks India Private Limited is an independent entity established to manage and develop financial benchmarks. It collects market data to ensure that rates are transparent, research-backed, and free from manipulation. While it administers benchmarks like the Overnight Mumbai Inter-bank Offered Rate, these rates are based on actual transaction data rather than projected future interest rates or subjective estimates.

59. (B) The seller will pay the buyer USD 0.03 per Pound.

On the settlement date of a futures contract, the difference between the contracted rate and the market rate is settled in cash. If the market rate is higher than the contracted rate for a buyer, the seller must pay the difference to the buyer. In this case, the difference of zero point zero three dollars per pound is paid accordingly.

60. (C) Both I and II are correct

The publication of the Overnight Mumbai Inter-bank Offered Rate follows a strict daily schedule, typically occurring at ten forty-five in the morning. However, if the transaction data does not meet certain threshold criteria, the announcement time can be delayed. Both the standard timing and the provision for extensions are parts of the operational framework used to ensure benchmark accuracy.

61. (A) Contracts written on treasury bonds deal in short-term interest rates.

Interest rate futures are popular tools for hedging, but the underlying instruments differ by tenor. Treasury bill futures are used for short-term interest rate risks, whereas contracts based on treasury bonds are designed for long-term rates. It is incorrect to state that treasury bond contracts deal with short-term rates, as they typically represent government debt with much longer maturities.

62. (D) To verify the client's risk policy and conduct suitability checks

Before offering complex or exotic derivative products, banks have a critical regulatory and ethical obligation to their clients. They must ensure that the products are suitable and appropriate for the client's financial needs and risk appetite. This involves verifying that the client has a formal risk management policy and understands the significant risks embedded within these sophisticated financial instruments.

63. (D) The falling bond price generates a futures profit that offsets the higher loan interest

Short selling treasury futures is a common strategy to hedge against rising interest rates. When interest rates go up, the prices of bonds and their corresponding futures contracts fall. This decrease in price generates a profit for the short

CHAPTER 25

Treasury and Asset Liability Management

May/June 2016

1. A newly appointed Treasury dealer at Sigma Bank conducts a complex foreign exchange swap transaction and is unsure about the specific market-related code of conduct to follow for settlement disputes. Which bodies, representing market players in specific segments, are responsible for evolving and standardizing such current market practices and codes of conduct?
- (A) Only the Ministry of Finance
 - (B) Self-Regulatory Organisations (SROs) such as FIMMDA and FEDAI
 - (C) The Indian Banks' Association (IBA) exclusively
 - (D) The Board of Directors of the respective counterparty bank

Oct/Nov 2020

2. Consider the following statements regarding the role of the Treasury head and the Treasury department in a bank:
- I. Market risk management operations have become an integral part of the treasury function.
 - II. The ALCO support group is often embedded within the treasury team.
 - III. The Treasury head contributes exclusively to risk management and is barred from product pricing discussions.
 - IV. The Treasury head is an important member of the Asset Liability Management Committee (ALCO).

Which combination of statements is correct?

- (A) I, II, and III only
- (B) I, II, and IV only
- (C) II, III, and IV only
- (D) I, III, and IV only

May/June 2007

3. What is the maximum period up to which banks can accept deposits?
- (A) 60 months
 - (B) 100 months
 - (C) 120 months

(D) 180 months

Oct/Nov 2024

4. Sigma Bank decides to fund a medium-term retail loan of 3 years using short-term inter-bank deposits that have an average maturity of just 3 months. The bank wishes to protect its net interest margin over the 3-year period against rising market rates. What derivative strategy can the Treasury execute to effectively protect the spread?
- (A) Buy a 3-month put option on a corporate equity index
 - (B) Enter an interest rate swap to pay a floating rate and receive a fixed rate for 3 years
 - (C) Securitize the 3-month deposits into Pass-Through Certificates
 - (D) Enter an interest rate swap to pay a fixed rate for 3 years and receive a floating rate linked to a benchmark

May/June 2015

5. Which of the following is a correct statement regarding market risk in banking operations?
- (A) It is restricted to the trading book and does not impact the total balance sheet.
 - (B) It is managed through conventional credit supervision and routine loan recovery.
 - (C) It only arises when a bank deals in complex foreign exchange derivatives.
 - (D) It manifests as liquidity and interest rate risks across the balance sheet.

Oct/Nov 2009

6. Which of the following product structures are utilized by Treasury to help reduce balance sheet mismatches and cater to investor risk appetite?
- I. Floating rate loans where interest rates are linked to a benchmark rate
 - II. Government securities where the interest rate is linked to the rate of inflation
 - III. Corporate debt paper issued with embedded call and put options
- Which combination is correct?

Oct/Nov 2021

30. Consider the following statements regarding the concept and mechanics of Transfer Pricing within a bank:
- It is an integral function of asset-liability management managed by the Treasury.
 - It refers to fixing the cost of resources and the return on assets of the bank in a rational manner.
 - The Treasury notionally buys and sells deposits and loans of the banking department.
 - The transfer prices are determined solely by the retail branch managers based on customer relationships.
 - The pricing considers market rates of interest, hedging costs, and the cost of maintaining reserve assets.

Which combination of statements is correct?

- I, II, III, and V only
- I, II, IV, and V only
- II, III, IV, and V only
- I, II, III, IV, and V

May/June 2024

31. Apart from traditional gap management, banks employ various advanced methods to measure asset-liability mismatches and assess ALM risk. These advanced methods include all of the following EXCEPT:
- Value at Risk (VaR)
 - Present Value calculations
 - Duration analysis
 - Historical cost amortization

Oct/Nov 2008

32. Which of the following statements about the impact of a transfer pricing mechanism is incorrect?
- It provides a rational basis for assessing the profitability of banking activities across multiple branches.
 - It allows the Treasury to centrally manage the liquidity and interest rate risks of the entire bank.
 - It involves the Treasury determining buy/sell prices on the basis of market interest rates.
 - It ensures that the profits of the credit department reflect both market risk and credit risk.

May/June 2006

33. Which of the following pairs linking derivative complexity to the recommended approach for determining capital requirement is incorrectly matched?
- Derivative instruments like forwards and swaps — Capital adequacy provision required
 - Deals in sophisticated derivative products — Historical Cost Approach
 - Options with zero cost structures — Simplified approach under Basel 3
 - Banks which write options — Delta-Plus Method

Oct/Nov 2016

34. Beta Bank's ALCO is reviewing the liquidity buffers for the next 14 days. The bank holds a portfolio of AAA-rated corporate bonds that are actively traded on the national exchanges with high daily volumes. According to standard treasury terminology, how should these specific bonds be classified to assure the ALCO of their utility in meeting immediate cash outflows?
- As illiquid statutory reserves maintained for regulatory compliance.
 - As long-term non-performing assets being recovered by the bank.
 - As liquefiable securities that can be readily sold in secondary markets.
 - As non-marketable credit derivatives used for hedging exposures.

May/June 2008

35. Which of the following statements about the impact of a interest rate risk dynamics between Indian banks and their depositors is incorrect?
- Banks impose heavy financial penalties on depositors for extensions.
 - Depositors in India prefer a fixed-rate interest regime for savings.
 - When market deposit rates fall, depositors stay at the older rate.
 - Behavioral patterns of depositors transfer interest rate risk to the bank.

Oct/Nov 2013

36. Match the specific banking policy in List I with its core prescriptions in List II.
- List I: (Banking Policies)
- ALM Policy
 - Liquidity Policy

May/June 2005

13. The net cumulative negative mismatch for a bank in the 'next day' time bucket should not exceed what percentage of the cumulative cash outflows?
- (A) 5%
(B) 10%
(C) 15%
(D) 20%

Oct/Nov 2018

14. When Treasury uses derivatives to hedge aggregate risks reflected in asset-liability mismatches, a dynamic management of the hedge is necessary. Which of the following factors mandate this dynamic management?
- I. The continuous repayment and origination of loans
II. The daily withdrawal and fresh mobilization of customer deposits
III. The fixed and unalterable nature of the bank's equity capital
- Which combination is correct?
- (A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

May/June 2014

15. Examine the following statements of Assertion (A) and Reason (R) and select the correct answer from the options below.
- Assertion (A): Liquidity risk and interest rate risk are considered two sides of the same coin.
Reason (R): Liquidity risk translates into interest rate risk when a bank has to recycle deposit funds or rollover credit on market-determined terms.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2006

16. Consider the following statements regarding why a bank's Treasury might prefer investing in corporate bonds over extending conventional bank loans:

- I. The bond serves as a more liquid asset because it is tradable in the secondary market.
II. The bank has an easy exit option by selling the bond, even at a discount, if the issuer's credit status deteriorates.
III. Corporate bonds cannot be marked-to-market, which protects the bank from revealing potential losses.
IV. The non-SLR investment portfolio of the treasury is highly flexible and ideal from an ALM perspective.

Which combination of statements is correct?

- (A) I, II, and III only
(B) I, II, and IV only
(C) II, III, and IV only
(D) I, III, and IV only

May/June 2023

17. Match the time buckets in List I with their corresponding maximum permitted net cumulative negative mismatch percentages in List II.

List I: (Time Buckets)

- P. Next day
Q. 2-7 days
R. 8-14 days
S. 15-28 days

List II: (Mismatch Percentages)

1. 10%
2. 20%
3. 5%
4. 15%
- (A) P-3, Q-1, R-4, S-2
(B) P-1, Q-3, R-2, S-4
(C) P-3, Q-4, R-1, S-2
(D) P-4, Q-2, R-3, S-1

Oct/Nov 2017

18. Zeta Bank has exhausted its direct lending pipeline in the retail automobile sector but currently possesses significant surplus liquidity in its Treasury. The ALCO mandates an increase in the bank's exposure to the retail sector without originating new direct loans. How can the Treasury effectively execute this mandate?
- (A) By lowering the interest rates offered on all standard savings account deposits.
(B) By purchasing unsecured short-term commercial paper from major technology companies.
(C) By investing surplus funds in PTCs backed

NODIA

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2021

7. Beta Bank's deposit portfolio consists predominantly of funds with an average maturity of one year. However, the bank has aggressively extended mortgage loans with an average maturity exceeding five years at a fixed interest rate. When the one-year deposits mature, the bank must raise fresh deposits at current market rates to meet obligations. If the new market interest rates are significantly higher than the contracted rates on the mortgage advances, what dual risks does Beta Bank face?
- (A) Credit default risk and foreign exchange risk
 - (B) Liquidity problem upon deposit maturity and reduction in net interest income
 - (C) Regulatory penalty for exceeding the 120-month deposit limit and operational risk
 - (D) Premature loan repayment risk and surplus cash flow risk

Oct/Nov 2014

8. Which of the following accurately describes the preconditions required for the efficient use of derivatives in managing ALM risks?
- (A) A developed derivative market and skilled dealers for accurate pricing.
 - (B) The bank must completely eliminate its credit risk portfolio before trading.
 - (C) Derivatives can only be used if the bank operates strictly in one currency.
 - (D) The central bank must provide a guarantee for all derivative counterparty risks.

May/June 2025

9. Consider the following statements regarding Asset Liability Management (ALM):
- I. ALM involves managing balance sheet risks that arise out of the mismatch of assets and liabilities.
 - II. If left uncontrolled, the mismatch of assets and liabilities can result in negative spreads or erosion of net worth.
- Which of the statements is/are correct?
- (A) Only I
 - (B) Only II

- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2010

10. Match the specific risk scenarios in List I with the appropriate Treasury hedging strategy in List II.

List I: (Risk Scenarios)

- P. Buying a stock highly sensitive to market movements
- Q. Hedging against currency risk when borrowing USD and lending in Rupees
- R. Meeting future repayment obligations of Foreign Currency loans
- S. Protecting the domestic value of future Foreign Currency receivables

List II: (Hedging Strategies)

- 1. Buying call options
- 2. Buying put options
- 3. Selling index futures
- 4. Paying a forward premium
- (A) P-3, Q-4, R-1, S-2
- (B) P-4, Q-3, R-2, S-1
- (C) P-3, Q-1, R-4, S-2
- (D) P-1, Q-2, R-3, S-4

May/June 2019

11. Consider the following combinations of sources to evaluate the available cash resources of a bank:
- I. Cash surpluses retained by the bank
 - II. Committed credit lines from other banks
 - III. Liquefiable securities and nostro balances
- Which combination is correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2022

12. Which of the following statements regarding the limitations of derivatives in ALM is incorrect?
- (A) Swaps rely on bank products being priced rationally based on benchmark rates.
 - (B) Grouping assets and liabilities into broad time bands leads to basis risk.
 - (C) Treasury can consistently construct a perfect hedge without residual risk.
 - (D) Options embedded in retail products complicate the effectiveness of hedging.

1. Pays a premium (akin to a guarantee fee) to mitigate credit risk
 2. Formed exclusively to handle securities paper, independent of parent company
 3. The annual fee expressed as a percentage of the notional amount
 4. Standalone Primary Dealers and NBFCs with sound financials
- (A) P-2, Q-1, R-4, S-3
 (B) P-1, Q-2, R-3, S-4
 (C) P-4, Q-3, R-2, S-1
 (D) P-2, Q-4, R-1, S-3

May/June 2017

25. Epsilon Bank mobilizes deposits of Rs. 100 crore with an average maturity of 6 months at 5% interest and invests the entire amount in a 5-year fixed interest loan yielding 7% p.a. Initially, the bank earns a net interest income (NII) spread of 2%. After 6 months, the deposits mature and the bank is forced to renew them at the new prevailing market rate of 8%. Assuming the loan continues to yield 7%, what is the impact on the bank's NII for the renewed period?
- (A) The NII remains a positive 2% spread.
 (B) The NII is reduced but remains a positive 1% spread.
 (C) The NII becomes a negative 1% spread.
 (D) The NII becomes a negative 3% spread.

Oct/Nov 2005

26. Regarding the regulatory stance and framework for Credit Default Swaps (CDS) in India, consider the following statements:
- I. The Reserve Bank of India has allowed the unrestricted trading of complex synthetic CDOs to boost market liquidity.
 - II. Standard regulations have introduced single-name Credit Default Swaps specifically on corporate bonds.
 - III. Commercial banks are permitted to act both as market-makers and as users of CDS.
- Which combination is correct?
- (A) I and II only
 (B) II and III only
 (C) I and III only
 (D) I, II, and III

May/June 2020

27. Which of the following correctly identifies the methods used to measure the interest rate

mismatch between rate-sensitive assets and rate-sensitive liabilities?

- (A) Via absolute amounts, sensitivity ratios, or asset-liability percentages.
 (B) By calculating the percentage of total non-performing assets in the bank.
 (C) By measuring exclusively as an absolute monetary amount of the portfolio.
 (D) By calculating the Present Value of future dividend payouts to shareholders.

Oct/Nov 2015

28. The global financial crisis (2008-2009) exposed severe negative aspects of securitization and credit derivatives. Which of the following was NOT one of the negative aspects or outcomes highlighted during this period?
- (A) Financial institutions became negligent in assessing asset credit quality.
 (B) Protection value disappeared when the underlying credit market crashed.
 (C) Counterparty risk safely eliminated the underlying credit risk of loans.
 (D) Lending banks remained exposed by retaining part of the underlying risk.

May/June 2013

29. Consider the following statements regarding market risk measurement and capital requirements:

- I. Regulations stipulate capital adequacy requirements for market risk, which includes interest rate mismatches.
- II. Capital must be provided for derivative instruments like forwards, options, and swaps used to bridge mismatches.
- III. Standard practices recommend a simplified approach for determining capital requirements for sophisticated derivatives with zero cost structures.
- IV. The Delta-Plus Method and Scenario Approach are recommended for banks that write options.
- V. Gap management is the only recognized method for measuring asset-liability mismatches.

Which combination of statements is correct?

- (A) I, II, III, and IV only
 (B) II, III, IV, and V only
 (C) I, III, IV, and V only
 (D) I, II, III, IV, and V

disbursements

- (D) Only through the issuance of physical currency notes

May/June 2012

56. Identify the correct pair representing the relationship between advances and deposits in a specific time bucket and the resulting liquidity gap.

- (A) Advances > Deposits : Positive Gap
(B) Advances > Deposits : Negative Gap
(C) Deposits > Advances : Positive Gap
(D) Deposits = Advances : Maturity mismatch

Oct/Nov 2022

57. What is the underlying financial mechanism achieved through the process of securitization by a bank?

- (A) Converting illiquid credit receivables into tradable certificates via SPVs.
(B) The bank absorbs market risk by guaranteeing the principal of defaulted bonds.
(C) The bank transfers its operational risk to an insurance company via premiums.
(D) The central bank directly purchases the retail deposits of the bank for cash.

May/June 2019

58. Gamma Bank holds a large volume of high-rated corporate bonds classified as liquefiable securities, intended to cover expected cash outflows in the 8-14 days bucket. However, an unexpected market disruption causes trading in these bonds to completely halt, preventing the bank from selling them. Which risk has materialized for Gamma Bank in this scenario?

- (A) Sovereign risk
(B) Liquidity risk arising from market illiquidity
(C) Repricing risk due to floating interest rates
(D) Currency mismatch risk

Oct/Nov 2017

59. Consider the following mechanics of a standard credit default swap (CDS):

- I. The instrument segregates credit risk from the underlying loan or investment asset.
II. The protection buyer guarantees the payment of principal to the protection seller.
III. A reference asset, such as a large corporate bond, dictates the underlying credit exposure.

- IV. In consideration for the protection against a credit event, the protection buyer pays a periodic premium to the seller.

Which combination of statements is correct?

- (A) I, II, and III only
(B) I, III, and IV only
(C) II, III, and IV only
(D) I, II, III, and IV

May/June 2005

60. Why do banks pay special attention to intra-day to one-month liquidity, despite having long-term profitability?

- (A) Short-term liquidity generates the highest net interest margin for the bank.
(B) Regulators mandate that all bank profits must come from one-month investments.
(C) Suspicion of pressure can prompt a bank run, threatening its survival.
(D) Long-term liquidity cannot be measured accurately using modern ALM tools.

Oct/Nov 2024

61. Examine the following statements of Assertion (A) and Reason (R) and select the correct answer from the options below.

Assertion (A): Credit derivatives are considered highly leveraged instruments.

Reason (R): The protection fee (credit default spread) paid upfront or periodically is only a very tiny portion of the notional value of the underlying credit.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

May/June 2016

62. How is Interest Rate Risk formally defined in the context of bank earnings?

- (A) The risk of loss in principal value of high-grade government securities.
(B) The risk of depositors withdrawing funds prematurely due to lower rates.
(C) Erosion of Net Interest Income (NII) due to market rate movements.
(D) The risk of a borrower failing to meet interest obligations on time.

R. Derivatives Policy

S. Investment Policy

List II: (Core Prescriptions)

1. Prescribes norms for capital allocation and valuation of forwards, options, and swaps
2. Prescribes permissible private placements, SLR and Non-SLR classifications, and accounting policy
3. Prescribes the composition of ALCO and methods to improve or maintain the existing NIM
4. Prescribes limits on exposure to money market and contingent funding lines

(A) P-3, Q-4, R-1, S-2

(B) P-4, Q-3, R-2, S-1

(C) P-3, Q-1, R-4, S-2

(D) P-2, Q-4, R-1, S-3

May/June 2018

37. The primary operational reason that the identification and monitoring of a bank's market risk is centralized within the Treasury department?

(A) The Treasury department is solely responsible for extending corporate credit.

(B) The Treasury is the only department authorized to interact with depositors.

(C) The Treasury manages physical cash vaults across all branch office locations.

(D) Treasury links core banking functions to the external financial markets.

Oct/Nov 2012

38. Match the following treasury and risk management terms in List I with their correct definitions in List II.

List I: (Terms)

P. Run on the Bank

Q. Sensitivity Ratio

R. Risk Appetite

S. Credit Default Spread (CDS)

List II: (Definitions)

1. Capacity and willingness to absorb losses on account of market risk
2. The annual fee the credit protection buyer must pay, expressed as a % of notional amount
3. Ratio of interest rate sensitive assets to rate sensitive liabilities
4. A situation where depositors lose confidence and withdraw balances immediately

(A) P-4, Q-3, R-1, S-2

(B) P-4, Q-1, R-3, S-2

(C) P-3, Q-4, R-2, S-1

(D) P-1, Q-2, R-4, S-3

May/June 2011

39. Omega Bank's retail division generates a significant negative liquidity gap in the 1-year bucket. Simultaneously, the Treasury desk takes independent trading positions in the securities market that inadvertently create a positive liquidity flow in the exact same 1-year bucket. How should the Treasury approach hedging in this compensatory scenario?

(A) It must hedge the gross exposure of the retail division and ignore its own trading positions.

(B) It can allow the compensatory risks to naturally offset each other and choose to hedge only the net residual risk.

(C) It should close its trading positions immediately as they conflict with retail operations.

(D) It must double the hedge to cover both the retail risk and the trading risk independently.

Oct/Nov 2019

40. The Composite Risk Policy for Foreign Exchange and Treasury specifically prescribes norms and limits for various operational exposures. Which of the following elements are typically included in this policy?

I. Limits on intra-day trading positions

II. Limits on overnight trading positions

III. Stop-loss limits for trading activities

IV. Periodical valuation of trading positions

V. The exact retail interest rate applied to savings accounts

Which combination of statements is correct?

(A) I, II, III, and IV only

(B) II, III, IV, and V only

(C) I, III, IV, and V only

(D) I, II, III, IV, and V

May/June 2022

41. Identify the correct pair that reflects the organizational relationship between Treasury and Asset Liability Management operations within a bank.

(A) ALCO Support Group : Forms a part of the Treasury team

(B) Treasury Head : Excluded from ALCO to prevent conflicts of interest

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by retail consumer loan portfolios.

- (D) By selling sovereign gold bonds to retail customers through the branch network.

May/June 2012

19. Delta Bank is formulating its Liquidity Management Policy to address potential shortfalls in short-term liquidity. The Asset Liability Management Committee suggests incorporating specific contingency measures. Which of the following actions should the bank include as a valid contingency measure?
- (A) Maintaining excess securities to borrow under a Liquidity Adjustment Facility.
- (B) Increasing the tenure of all retail deposits to 120 months to secure funding.
- (C) Converting all floating-rate advances to fixed-rate advances for the bank.
- (D) Suspending all credit disbursements permanently to conserve the bank's cash.

Oct/Nov 2011

20. Arrange the following events depicting the failure of credit derivatives during the 2008-2009 global financial crisis in their logical sequential order:
- I. The underlying mortgage crisis hit, and the value offered by protection institutions disappeared.
- II. Banks and investment institutions became negligent in assessing asset credit quality, securitizing them immediately.
- III. Governments were forced into huge bail-outs to prevent the bankruptcy of large financial institutions.
- IV. Trading in credit derivatives skyrocketed, with fund managers creating swaps based on synthetic assets.
- (A) II, IV, I, III
- (B) II, I, IV, III
- (C) IV, II, III, I
- (D) I, II, IV, III

May/June 2009

21. Consider the following statements regarding the mapping of ALM elements:
- I. Assets yielding income on maturity are plotted as cash inflows.
- II. Liabilities needing repayment on maturity are plotted as cash outflows.
- III. Asset-liability mismatch represents a fundamental cash flow mismatch.

- IV. A currency mismatch only occurs when all inflows are in domestic currency and all outflows are in foreign currency.

Which combination of statements is correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2025

22. Omega Bank holds a massive exposure to a single infrastructure conglomerate within its Banking Book. The risk management committee warns that a default by this conglomerate would severely erode the bank's net worth. How can Omega Bank utilize Credit Default Swaps (CDS) to mitigate this specific risk?
- (A) By acting as a CDS market-maker and aggressively selling protection to other banks
- (B) By demanding the central bank issue a sovereign guarantee in exchange for CDS premiums
- (C) By acting as a CDS user and buying a single name CDS on the conglomerate's corporate bonds to hedge the exposure
- (D) By short-selling the conglomerate's equity stock in the derivatives segment

May/June 2010

23. A bank discovers that within the 6-month to 1-year time bucket, the total volume of assets subject to interest rate changes significantly exceeds the volume of liabilities subject to interest rate changes. What specific type of risk is the bank directly exposed to in this time bucket?
- (A) Credit default risk
- (B) Repricing risk
- (C) Basis risk
- (D) Currency mismatch risk

Oct/Nov 2023

24. Match the terms related to Credit Derivatives and Securitization in List I with their corresponding descriptions in List II.
- List I: (Terms)
- P. Special Purpose Vehicle (SPV)
- Q. Protection Buyer
- R. Market-Makers in CDS
- S. Credit Default Spread
- List II: (Descriptions)

sensitive assets and liabilities.

- (D) The failure of a borrower to repay the principal on a mortgage loan.

Oct/Nov 2009

49. What is the most significant financial advantage for a bank when utilizing derivative instruments as opposed to cash market instruments for hedging purposes?

- (A) Derivatives guarantee a zero percent basis risk for all treasury operations.
 (B) Low capital commitment with no upfront deployment of principal funds.
 (C) Derivatives permanently transfer the underlying credit risk to the central bank.
 (D) Derivatives automatically extend the maturity of all underlying retail deposits.

May/June 2013

50. In Asset Liability Management, how is a liquidity gap defined?

- (A) The difference between total statutory reserves and actual cash in hand
 (B) The difference between fixed interest rates and floating interest rates
 (C) The difference between sources and uses of funds in specific time bands
 (D) The difference between foreign currency assets and domestic currency liabilities

Oct/Nov 2018

51. Kappa Bank's Treasury invests in a corporate bond that has a stated maturity of 7 years. However, the bond features an embedded put option exercisable at the end of the 3rd year. For the purpose of ALM mapping and measuring liquidity risk, how should the Treasury classify the effective maturity of this investment assuming the option is likely to be exercised?

- (A) As a strictly 7-year investment
 (B) As an indefinite equity investment
 (C) As effectively a 3-year investment
 (D) As a 10-year investment due to the premium paid

May/June 2023

52. Which of the following statements regarding the measurement of liquidity risk is incorrect?

- (A) Assets yielding income are shown as cash inflows on maturity.
 (B) Liabilities that need to be repaid are shown as cash outflows on maturity.

- (C) A currency mismatch arises if part of the inflow or outflow is denominated in foreign currency.

- (D) A positive liquidity gap occurs when deposits exceed advances in a given time bucket.

Oct/Nov 2025

53. Consider the following statements regarding the application of derivatives in ALM:

- I. Derivatives can be used to structure new products that help overcome market risk.
 II. In exchange-traded derivative instruments, the margin requirement is typically a fraction of the notional amount.
 III. Derivatives can be applied to hedge high-value individual transactions.
 IV. Derivatives can be applied to hedge aggregate risks as reflected in asset-liability mismatches.
 V. Because the composition of assets and liabilities is static, hedge management requires only a one-time setup without dynamic adjustments.

Which combination of statements is correct?

- (A) I, II, III, and IV only
 (B) II, III, IV, and V only
 (C) I, III, IV, and V only
 (D) I, II, III, IV, and V

May/June 2010

54. Arrange the following short-term liquidity time buckets in the correct sequential order as prescribed for monitoring net cumulative negative mismatches:

- I. 8 to 14 days
 II. Next day
 III. 15 to 28 days
 IV. 2 to 7 days
 (A) II, I, IV, III
 (B) II, IV, I, III
 (C) IV, II, III, I
 (D) II, IV, III, I

Oct/Nov 2011

55. In the normal course of treasury operations, how is the inherent credit risk primarily manifested?

- (A) Through the retail mortgage lending portfolio
 (B) Only with respect to counterparty dealings in market transactions
 (C) Through uncollateralized microfinance

- (C) ALM Desk : Completely independent from the dealing room
- (D) Product Pricing : Sole responsibility of the branch managers

Oct/Nov 2007

42. How is Asset-Liability Management (ALM) ultimately defined in the context of banking risks?
- (A) As the generation of maximum net interest margin
 - (B) As the protection of net worth of the bank
 - (C) As the elimination of liquidity and credit risks
 - (D) As the management of daily cash outflows

Oct/Nov 2014

43. In the context of derivative hedging within ALM, what is the precise definition of 'basis risk'?
- (A) Residual market risk from broad time bands or imperfect hedge alignment.
 - (B) The risk that a counterparty will default on a credit or interest rate swap.
 - (C) The risk of financial loss arising from operational failures in a contract.
 - (D) The foundational credit risk inherent in the reference asset of a swap.

May/June 2024

44. Which of the following best explains why a bank assumes market risk and credit risk while deploying funds?
- (A) Depositors mandate high-risk positions to maximize capital market returns.
 - (B) The central bank forces banks to expose funds to market price volatility.
 - (C) The bank acts as a maturity and risk intermediary for its depositors.
 - (D) Retail depositors underwrite market risk, leaving credit risk for the bank.

Oct/Nov 2005

45. Theta Bank's Treasury executes an arbitrage strategy by borrowing USD funds for 6 months at an interest cost of 3% p.a., and simultaneously lending the equivalent Rupee funds in the domestic market at a yield of 6.5% p.a. To hedge against the currency risk, the Treasury pays a forward premium of 1.5% p.a. What is the net risk-free interest spread earned by Theta Bank on this transaction?
- (A) 2.0%

- (B) 3.5%
- (C) 5.0%
- (D) 8.0%

May/June 2007

46. Alpha Bank accepts a 3-year term deposit at a fixed rate of 8% p.a. and utilizes these funds to provide a 90-day bill discounting facility to a corporate borrower. During the first year, market interest rates steadily decline, and by the second year, the bank can only charge 7% on the working capital loan. What is the immediate financial consequence for Alpha Bank in this scenario?
- (A) A positive spread generated by the shorter repricing tenure of the facility.
 - (B) The elimination of credit risk by frequent repricing of the loan facility.
 - (C) Negative earnings as deposit costs exceed the yield on the repriced loan.
 - (D) A severe liquidity crisis caused by depositors demanding early withdrawal.

Oct/Nov 2020

47. Examine the following statements of Assertion (A) and Reason (R) and select the correct answer from the options below.
- Assertion (A): Prepayments of fixed deposits or term loans can escape standard ALM analysis and cannot be fully hedged by the bank.
- Reason (R): These products contain embedded options that grant the customer the right to alter the cash flow schedule, disrupting the time buckets assumed in ALM.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2021

48. While assessing the risks inherent in a bank's balance sheet, all of the following are considered manifestations of market risk EXCEPT:
- (A) The inability to find enough cash to fund a substantial liquidity gap.
 - (B) The erosion of Net Interest Income due to adverse interest rate movements.
 - (C) The mismatch in repricing dates of rate-

Oct/Nov 2006

63. In the classification of eligible entities for Credit Default Swaps (CDS) in India, which of the following entity categories is incorrectly paired with its permitted role?
- (A) Commercial Banks : Permitted as both Market-makers and Users
 - (B) Standalone Primary Dealers (PDs) : Permitted as Market-makers
 - (C) Listed Corporates : Permitted as Users
 - (D) Provident Funds : Permitted as Market-makers

May/June 2015

64. Consider the following statements regarding the measurement of interest rate mismatches:
- I. All assets and liabilities are placed in time buckets based exclusively on their final maturity dates, ignoring interim interest changes.
 - II. The mismatch in each time bucket is measured as a gap between rate sensitive assets and rate sensitive liabilities.
- Which of the statements is/are correct?
- (A) Only I
 - (B) Only II
 - (C) Both I and II
 - (D) Neither I nor II

Oct/Nov 2013

65. All of the following institutions are explicitly listed as eligible 'Users' for Credit Default Swaps (CDS) EXCEPT:
- (A) Provident Funds
 - (B) Unlisted Retail Proprietorships
 - (C) Foreign Institutional Investors (FIIs)
 - (D) Listed Corporates

May/June 2017

66. Examine the following statements of Assertion (A) and Reason (R) and select the correct answer from the options below.
- Assertion (A): A loan being repaid in the 6-month to 1-year time bucket is considered due for repricing, whereas a fixed-rate Tier-2 bond maturing in 7 years is not due for repricing in the same bucket.
- Reason (R): Fresh lending of the repaid loan amount can only take place at current market rates, while the fixed-rate bond remains insensitive to market price changes until its maturity.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2008

67. Which framework standardizes the various covenants and legal protocols for transactions involving Credit Derivatives globally?
- (A) The ISDA Master Agreement for Credit Derivatives
 - (B) The FEDAI Master Direction on Forex
 - (C) The Basel III Accords on Securitization
 - (D) The FIMMDA Code of Conduct for Government Securities

May/June 2020

68. If a bank identifies a significant repricing mismatch where its liabilities are floating and its assets are fixed, what is the most effective Treasury mechanism to reduce this specific interest rate mismatch?
- (A) Issuing new equity shares to retail investors
 - (B) Converting all liquid investments into long-term illiquid bonds
 - (C) Refusing to accept any further deposits until the mismatch resolves organically
 - (D) Swapping the fixed rate to a floating rate using derivative instruments

Oct/Nov 2016

69. What is the most compelling reason a bank's Treasury would supplement its credit portfolio by purchasing corporate bonds in the debt market rather than the bank issuing a direct bilateral loan?
- (A) Corporate bonds offer higher interest rates than the standard Base Rate/MCLR.
 - (B) Direct loans must be marked-to-market daily, while corporate bonds are held at cost.
 - (C) Corporate bonds are completely immune to interest rate fluctuations in the market.
 - (D) Tradable bonds offer an easy exit if the issuer's credit quality declines.

May/June 2018

70. Zeta Bank operates in a market where retail depositors historically prefer fixed-rate term

deposits. Following a sudden hike in the central bank's policy rates, prevailing market deposit rates rise by 150 basis points. Based on typical depositor behavior and banking practices in India, what action are the depositors most likely to take, and how does it impact the bank?

- (A) Leave existing deposits untouched, allowing the bank to enjoy wider margins.
- (B) Request conversion of fixed deposits into floating-rate deposits for inflation.
- (C) Prematurely extend deposits at higher rates, nullifying bank benefits.
- (D) Withdraw funds to invest in the stock market, eliminating the deposit base.

Oct/Nov 2010

71. A bank's retail branch mobilizes a fixed deposit at an interest cost of 7%. The Treasury, factoring in liquidity and hedging costs, notionally buys this deposit from the branch at a transfer price of 6%. The branch also sanctions a loan at 10%, which it notionally 'sells' to the Treasury at a transfer cost of 7%. In this Transfer Pricing framework, what does the resulting profitability of the retail branch genuinely reflect?

- (A) The combined impact of liquidity risk and interest rate risk.
- (B) Credit risk, net of mismatches in sources and uses of funds.
- (C) The market risk and foreign exchange risk of the bank.
- (D) The cost of maintaining mandatory statutory reserves.

May/June 2008

72. Consider the following statements regarding the impact of the Marginal Cost of Funds based Lending Rate (MCLR) system in a falling interest rate scenario:
- I. The MCLR system functions as a floating rate of interest for advances.
 - II. When interest rates fall, the bank's Net Interest Margin (NIM) typically increases because deposit costs fall faster than loan yields.
 - III. In a falling rate scenario, the bank's NIM contracts because retail deposits remain at a fixed rate while advances are repriced downwards.

Which combination of statements is correct?

- (A) I and II only
- (B) I and III only

- (C) II and III only
- (D) I only

Oct/Nov 2012

73. Consider the following statements regarding Transfer Pricing:

- I. In a multi-branch banking environment, transfer pricing is particularly useful to accurately assess individual branch profitability.
- II. The notional transfer prices set by the Treasury remain identical for all deposits and loans, regardless of their specific tenor or maturity.

Which of the statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2011

74. On which date did the Reserve Bank of India introduce the Marginal Cost of Funds based Lending Rate (MCLR) system for pricing bank advances?

- (A) 1st January 2015
- (B) 1st April 2016
- (C) 1st July 2017
- (D) 1st April 2018

Oct/Nov 2019

75. An Integrated Risk Management Policy, bearing upon the Market Risk of the Bank, typically includes several specialized policy components overseen by the ALCO. Which of the following policies is explicitly EXCLUDED from the purview of ALCO?

- (A) Risk Management Policy for Operational Risk
- (B) Composite Risk Policy for Foreign Exchange and Treasury
- (C) Liquidity Policy
- (D) Asset Liability Management (ALM) Policy

May/June 2025

76. Consider the following statements regarding hedging interest rate risk in the Indian banking scenario:

- I. It is easy for Indian banks to seamlessly hedge their entire interest rate risk because retail depositors actively trade in interest rate derivatives.

- II. Hedging the entire interest rate risk is difficult because most major players, such as banks, tend to be on the same side of the market.

Which of the statements is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2021

77. Which of the following are essential structural and regulatory requirements for a bank's market risk policies?

- I. They must be approved at the highest level, either by the Board or a Board committee.
- II. They should comply with current market practices and codes of conduct evolved by Self-Regulatory Organisations (SROs).
- III. They are permanent documents that strictly prohibit any form of annual review.
- IV. In most cases, there is a requirement to file a copy of the policy with the regulator.

Which combination of statements is correct?

- (A) I, II, and III only
- (B) I, II, and IV only
- (C) II, III, and IV only
- (D) I, III, and IV only

May/June 2009

78. Examine the following statements of Assertion (A) and Reason (R) and select the correct answer from the options below.

Assertion (A): It is neither possible nor advisable for a bank to completely eliminate all asset-liability mismatches from its balance sheet.

Reason (R): Assets and liabilities cannot be physically shifted across time bands, and the bank actually generates profit by managing these inherent mismatches.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2007

79. According to the policy environment framework for treasury operations, an Integrated Risk

Management Policy is supported by several distinct policies. Which of the following policies dictate the boundaries and methodologies of Treasury and Market Risk operations?

- I. Composite Risk Policy for Foreign Exchange and Treasury
- II. Transfer Pricing Policy
- III. Hedging Policy for customer risks
- IV. Prevention of Money Laundering Policy
- V. Risk Management Policy for Credit Risk

Which combination of statements is correct regarding policies that have an impact on treasury activity (excluding those out of ALCO's purview)?

- (A) I, II, III, and V only
- (B) I, II, III, and IV only
- (C) II, III, IV, and V only
- (D) I, III, IV, and V only

May/June 2022

80. Why might a bank choose to subscribe to a corporate entity's commercial paper through its Treasury instead of extending a traditional working capital loan?

- (A) Commercial paper carries zero credit risk compared to a standard bank loan.
- (B) The regulatory capital requirement for a commercial paper is double a loan.
- (C) Commercial paper yields a strictly floating rate to prevent repricing risk.
- (D) They are highly marketable, allowing quick liquidation to infuse cash.

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prescribed percentage limits. For the next day bucket, the limit is five percent, increasing to ten percent for the two to seven-day period.

The eight to fourteen-day bucket allows a fifteen percent mismatch, while the fifteen to twenty-eight-day bucket has a maximum permitted mismatch of twenty percent.

18. (C) By investing surplus funds in PTCs backed by retail consumer loan portfolios.

When a bank has surplus liquidity but no direct lending pipeline, it can increase its retail sector exposure through the treasury department.

By investing in Pass-Through Certificates backed by retail consumer loan portfolios, the bank achieves its sector targets. This strategy allows the treasury to deploy funds into the retail market indirectly while maintaining a portfolio of tradable assets.

19. (A) Maintaining excess securities to borrow under a Liquidity Adjustment Facility.

Liquidity management policies include contingency measures to address unexpected shortfalls in funding. One valid measure involves maintaining an excess pool of government securities.

These can be used to borrow funds through a Liquidity Adjustment Facility with the central bank. This provides a reliable source of short-term cash without needing to permanently suspend credit disbursements or change retail tenures.

20. (A) II, IV, I, III

The 2008 financial crisis began with institutions neglecting asset quality while aggressively securitizing loans. This led to a massive surge in credit derivative trading based on synthetic assets.

When the underlying mortgage market crashed, the protection offered by these instruments vanished, causing widespread financial instability. Ultimately, governments were forced to provide massive bailouts to prevent the collapse of major institutions.

21. (A) I, II, and III only

ALM mapping involves plotting expected cash flows to identify mismatches. Assets that yield income upon maturity are recorded as inflows,

while liabilities requiring repayment are marked as outflows.

This process reveals fundamental cash flow mismatches that require management. While currency mismatches occur when denominations differ, they are not limited only to cases where all funds are in one currency.

22. (C) By acting as a CDS user and buying a single name CDS on the conglomerate's corporate bonds to hedge the exposure

To mitigate a large single-name exposure in the banking book, an institution can utilize credit derivatives. By acting as a protection buyer and entering into a Credit Default Swap on the specific conglomerate's bonds, the bank hedges its risk.

If a default occurs, the CDS provider compensates the bank, effectively protecting its net worth without requiring the asset sale.

23. (B) Repricing risk

When the volume of assets subject to interest rate changes exceeds the volume of similarly sensitive liabilities within a specific time bucket, the bank faces repricing risk.

This specific type of interest rate risk occurs because the timing of rate adjustments for assets and liabilities does not perfectly align. Consequently, fluctuations in market rates will disproportionately impact the bank's earnings.

24. (A) P-2, Q-1, R-4, S-3

The credit derivatives market involves several key components and participants. A Special Purpose Vehicle is an independent entity formed specifically to handle securities paper.

Protection buyers pay an annual fee, known as the credit default spread, to mitigate credit risk. Meanwhile, market-makers, such as standalone primary dealers and NBFCs, facilitate trading by providing liquidity and quotes for instruments.

25. (C) The NII becomes a negative 1% spread.

In this scenario, the bank initially earns a positive spread of two percent. However, when the short-term deposits mature and are renewed at a higher market rate of eight percent, the cost of funds exceeds the fixed seven percent return from the long-term loan.

This mismatch results in the net interest income becoming a negative spread of one percent.

these complex contracts and understanding mathematical models to manage the inherent risks associated with such transactions.

9. (C) Both I and II

Asset Liability Management is a fundamental process focused on managing balance sheet risks stemming from mismatches in the timing of cash flows.

If these mismatches are left unmonitored, they can lead to negative interest spreads or significant erosion of the bank's net worth. Therefore, ALM seeks to align the maturity profiles of assets and liabilities to ensure stability.

10. (A) P-3, Q-4, R-1, S-2

Specific treasury hedging strategies are designed to address various market risks. Selling index futures helps mitigate risks from sensitive stock positions, while paying a forward premium hedges currency risk in foreign borrowing.

Call options are effective for future foreign currency loan repayments, and put options protect the domestic value of future receivables. Together, these provide a comprehensive framework.

11. (D) I, II, and III

To accurately evaluate available cash resources, a bank must consider several liquid sources. These include retained cash surpluses held within the institution and committed credit lines established with other banks for emergency funding.

Additionally, the assessment incorporates liquefiable securities that can be sold in the secondary market and nostro balances held in foreign currency accounts for international transactions.

12. (C) Treasury can consistently construct a perfect hedge without residual risk.

While derivatives are powerful tools for managing risks, they have inherent limitations. Constructing a perfect hedge that eliminates all residual risk is virtually impossible in practice.

Factors such as basis risk, arising from broad time band groupings, and the presence of embedded options in retail products complicate the process. Treasury must constantly monitor these instruments to manage remaining exposures.

13. (A) 5%

Regulatory authorities prescribe specific limits to manage short-term liquidity risks effectively. For the 'next day' time bucket, banks must ensure that their net cumulative negative mismatch does not exceed a set percentage of their total cumulative cash outflows.

This limit is strictly maintained at five percent to prevent immediate liquidity crises and ensure the bank meets daily obligations.

14. (A) I and II only

Managing hedges for aggregate asset-liability risks requires a dynamic approach due to the constantly changing nature of a bank's balance sheet.

The continuous repayment and origination of loans, alongside the daily fluctuations in customer deposit mobilization and withdrawals, alter the risk profile. Unlike equity capital, which remains relatively stable, these operational cash flows necessitate frequent adjustments to the hedging strategy.

15. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Liquidity risk and interest rate risk are intrinsically linked within banking operations. When a bank experiences a liquidity shortfall, it must recycle or rollover funds by borrowing from the market at current rates.

This process directly exposes the bank to interest rate fluctuations. Consequently, the terms on which funding is secured transform the initial liquidity challenge into a risk.

16. (B) I, II, and IV only

Treasury departments often favor corporate bonds over traditional loans due to their superior liquidity and flexibility. Bonds are tradable in secondary markets, providing an easy exit strategy if the issuer's credit quality declines.

Furthermore, the non-statutory liquidity ratio investment portfolio offers significant ALM benefits. These assets allow banks to manage their balance sheets more effectively than illiquid credit exposures.

17. (A) P-3, Q-1, R-4, S-2

Banks must monitor liquidity mismatches across various short-term time horizons using

- 51. (C)** As effectively a 3-year investment
When a bond features an embedded put option, its effective maturity for ALM purposes is adjusted to reflect potential early repayment. If the treasury determines that the option is likely to be exercised, the investment is classified based on the exercise date rather than the final stated maturity.
Consequently, a seven-year bond with a three-year put option is effectively mapped as a three-year asset.
- 52. (C)** The definition of a liquidity gap depends on the balance of these flows.
Measuring liquidity risk involves mapping assets as inflows and liabilities as outflows upon maturity. While a currency mismatch occurs if funds are denominated in different currencies, the definition of a liquidity gap depends on the balance of these flows. A negative liquidity gap occurs when deposits exceed advances in a given time bucket, indicating a need for additional funding.
A negative liquidity gap occurs when advances exceed deposits in a given time bucket, indicating a need for additional funding.
- 53. (A)** I, II, III, and IV only
Derivatives play multiple roles in managing asset-liability mismatches. They are used to structure products that mitigate market risk and to hedge both individual transactions and aggregate balance sheet risks.
Additionally, exchange-traded derivatives require only small margins relative to their notional amounts. Because the composition of assets and liabilities is constantly changing, treasury must perform dynamic management of these instruments.
- 54. (B)** II, IV, I, III
To effectively monitor short-term liquidity, banks must analyze their net cumulative negative mismatches across a series of chronological time buckets.
The standard sequence begins with the 'next day' bucket for immediate needs. This is followed by the 'two to seven days' bucket, then 'eight to fourteen days,' and finally the 'fifteen to twenty-eight days' bucket. This structured approach helps ensure stability.
- 55. (B)** Only with respect to counterparty dealings in market transactions
While credit risk is most commonly associated with a bank's lending portfolio, it also manifests within normal treasury operations.
In this context, credit risk primarily arises through counterparty dealings in market transactions. This includes the risk that a partner in a foreign exchange, money market, or derivative deal fails to fulfill their obligations, leading to financial loss for the bank.
- 56. (A)** Advances > Deposits : Positive Gap
In the context of liquidity gap analysis, the relationship between advances and deposits determines the funding position within a specific time bucket. When the total volume of advances exceeds the total volume of deposits, it results in a positive gap. This indicates that the bank has more fund inflows than outflows for that period, resulting in a surplus of liquidity.
When the total volume of advances exceeds the total volume of deposits, it results in a positive gap. This indicates that the bank has deployed more funds than it has sourced for that period, necessitating additional liquidity to balance books.
- 57. (A)** Converting illiquid credit receivables into tradable certificates via SPVs.
Securitization is a financial process that enhances a bank's liquidity and risk management. It involves converting illiquid credit receivables, such as retail or mortgage loans, into tradable certificates.
These securities are typically issued through a Special Purpose Vehicle, allowing the bank to sell them in the capital markets. This mechanism provides immediate cash and transfers specific risks to investors.
- 58. (B)** Liquidity risk arising from market illiquidity
Liquidity risk can arise from broader market disruptions rather than just internal cash shortfalls. When a bank holds high-rated bonds intended for liquidation but cannot sell them because trading in those assets has halted, it faces market illiquidity risk.
Even though the assets are theoretically valuable, the lack of an active secondary market prevents the bank from converting them.

26. (B) II and III only

The regulatory framework for Credit Default Swaps in India is designed to manage risk while providing market liquidity. Standard regulations permit the use of single-name CDS specifically on corporate bonds.

Under these guidelines, commercial banks are allowed to function as both market-makers and users. However, the trading of highly complex synthetic collateralized debt obligations remains restricted by the regulator.

27. (A) Via absolute amounts, sensitivity ratios, or asset-liability percentages.

Interest rate mismatches between rate-sensitive assets and liabilities are quantified using several standardized methods. Banks typically measure these gaps through absolute monetary amounts, sensitivity ratios, or asset-liability percentages.

These metrics help the Asset Liability Management Committee understand the extent of exposure to interest rate fluctuations and decide on appropriate hedging strategies to protect the bank's margin.

28. (C) Counterparty risk safely eliminated the underlying credit risk of loans.

The 2008 global financial crisis highlighted several negative aspects of securitization and credit derivatives. Financial institutions often became negligent in assessing asset quality, and protection value disappeared when markets crashed.

Crucially, counterparty risk did not eliminate the underlying credit risk; instead, it masked it. Lending banks also frequently remained exposed by retaining portions of the underlying risk.

29. (A) I, II, III, and IV only

Regulations require banks to maintain capital for market risks, including interest rate mismatches. This requirement extends to derivative instruments like forwards, options, and swaps used for hedging.

For banks that write options, sophisticated methods like the Delta-Plus Method or the Scenario Approach are recommended. These frameworks ensure that the bank has sufficient capital to absorb potential losses from complex activities.

30. (A) I, II, III, and V only

Transfer pricing is a vital treasury function used to rationally determine the cost of resources and returns on assets. The treasury notionally buys deposits and sells loans to banking departments based on market interest rates and hedging costs. This mechanism allows for centralizing risk management while ensuring that individual branch performance is evaluated fairly, independent of broader market fluctuations.

31. (D) Historical cost amortization

Banks utilize several sophisticated techniques beyond basic gap management to assess ALM risks. These include Value at Risk to estimate potential losses, Present Value calculations for future cash flows, and Duration analysis for interest rate sensitivity.

Historical cost amortization, however, is an accounting method rather than an advanced tool for measuring active market-related asset-liability mismatches and dynamic exposures.

32. (D) It ensures that the profits of the credit department reflect both market risk and credit risk.

A robust transfer pricing mechanism allows a bank to centralize its liquidity and interest rate risk management within the treasury. This system provides a rational basis for assessing branch profitability by separating market risk from credit risk.

While the credit department's profits should reflect its success in managing credit risk, the treasury manages market-related variables for performance evaluation.

33. (B) Deals in sophisticated derivative products — Historical Cost Approach

Regulatory frameworks prescribe specific approaches for calculating capital requirements based on derivative complexity. Standard instruments like forwards and swaps require basic capital adequacy provisions.

Banks writing options must use the Delta-Plus Method, while zero-cost options fall under simplified Basel 3 approaches. The Historical Cost Approach is inappropriate for sophisticated derivative products, as they must be valued by market dynamics.

- 34.** (C) As liquefiable securities that can be readily sold in secondary markets.
AAA-rated corporate bonds that are actively traded on national exchanges are classified as liquefiable securities in treasury management. Because these assets have high daily trading volumes, they can be readily sold in the secondary market to generate cash.
This makes them highly effective buffers for meeting immediate cash outflows, providing assurance regarding the bank's short-term liquidity position.
- 35.** (A) Banks impose heavy financial penalties on depositors for extensions.
In the Indian banking context, depositors often prefer fixed-rate interest regimes for their savings. When market rates fall, they benefit from staying at older, higher rates. Conversely, if rates rise, behavioral patterns often lead them to extend deposits at higher rates.
Generally, banks do not impose heavy financial penalties for such extensions, which effectively transfers interest rate risk to the bank.
- 36.** (A) P-3, Q-4, R-1, S-2
Different banking policies address specific operational areas. The ALM policy focuses on committee composition and net interest margins, while the liquidity policy sets limits on money market exposure.
The derivatives policy handles capital allocation for swaps and options, and the investment policy governs SLR classifications and accounting. Together, these policies form a comprehensive framework for managing risks inherent in treasury operations.
- 37.** (D) Treasury links core banking functions to the external financial markets.
The identification and monitoring of market risk are centralized in the treasury because it serves as the vital link between core banking functions and external financial markets.
By operating at this intersection, the treasury can effectively manage interest rate and liquidity fluctuations that impact the entire institution. This centralization ensures that risk management strategies are aligned with current market conditions.
- 38.** (A) P-4, Q-3, R-1, S-2
Various terms define the treasury risk landscape. A 'run on the bank' occurs when depositors lose confidence and withdraw funds immediately. The sensitivity ratio compares interest rate sensitive assets to liabilities.
Risk appetite describes the capacity and willingness to absorb market-related losses. Finally, the credit default spread represents the annual fee paid by a protection buyer to mitigate specific credit risk.
- 39.** (B) It can allow the compensatory risks to naturally offset each other and choose to hedge only the net residual risk.
In scenarios where different divisions of a bank create offsetting liquidity flows, the treasury can adopt a net hedging approach.
When retail negative gaps are compensated by independent trading surpluses in the same time bucket, the risks naturally offset each other. The treasury then focuses on hedging only the net residual risk, which is a more efficient management strategy.
- 40.** (A) I, II, III, and IV only
The Composite Risk Policy for Foreign Exchange and Treasury establishes essential boundaries for trading activities. It typically includes specific limits for intra-day and overnight positions to control exposure.
Additionally, it mandates stop-loss limits and requires the periodical valuation of all trading positions to ensure transparency. While it governs market-related activities, it does not prescribe exact retail interest rates for savings accounts.
- 41.** (A) ALCO Support Group : Forms a part of the Treasury team
Within the organizational structure of a bank, the treasury department and Asset Liability Management operations are closely linked. The specialized ALCO Support Group, which provides data and analysis for decision-making, is typically an integral part of the treasury team. This arrangement ensures that the Treasury head, a key member of the committee, has direct access to necessary resources.
- 42.** (B) As the protection of net worth of the bank
While Asset Liability Management involves managing cash flows and interest margins, its

ultimate objective is more fundamental. In a comprehensive banking context, ALM is defined as the protection of the bank's net worth.

By managing the various risks arising from mismatches between assets and liabilities, the bank ensures its long-term financial stability and preserves equity value for its stakeholders.

43. (A) Residual market risk from broad time bands or imperfect hedge alignment.

In the context of derivative hedging, basis risk refers to the residual market risk that remains after a hedge is established.

It often arises because assets and liabilities are grouped into broad time bands or because the hedging instrument does not perfectly align with the underlying exposure. This risk signifies that even with derivatives, the bank may still face earnings fluctuations.

44. (C) The bank acts as a maturity and risk intermediary for its depositors.

Banks naturally assume market and credit risks because they function as maturity and risk intermediaries for their depositors. Retail depositors generally seek safe, liquid avenues for their funds and are often unwilling to bear direct market volatility.

The bank bridges this gap by transforming short-term deposits into long-term investments, managing the resulting price and default risks as part of its core business.

45. (A) 2.0%

To calculate the net risk-free interest spread, the bank must account for borrowing costs, lending yields, and hedging expenses. In this arbitrage strategy, the bank earns a six point five percent yield while paying three percent interest.

After subtracting the one point five percent forward premium paid to hedge currency risk, the resulting net spread for the institution is exactly two percent.

46. (C) Negative earnings as deposit costs exceed the yield on the repriced loan.

When a bank locks in high-cost, long-term deposits and utilizes them for short-term loans, it faces significant interest rate risk.

If market rates decline, the short-term facility will be repriced at a lower yield, while the deposit cost remains fixed at the original high rate. This

situation leads to negative earnings for the bank, as interest expenses exceed interest income.

47. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Prepayments of term loans and early withdrawals of fixed deposits present significant challenges for asset-liability management. These products contain embedded options that allow customers to change the timing of cash flows.

Because these choices are driven by external factors, they can disrupt the assumptions made during ALM mapping, making it difficult for the bank to achieve a perfect hedge.

48. (D) The failure of a borrower to repay the principal on a mortgage loan.

Market risk encompasses various threats to a bank's financial health, such as liquidity shortages, erosion of net interest income, and repricing mismatches. These issues stem from fluctuations in market rates and prices.

In contrast, the failure of a specific borrower to repay the principal on a loan is categorized as credit risk, which focuses on counterparty default potential.

49. (B) Low capital commitment with no upfront deployment of principal funds.

The most significant financial benefit of using derivatives over cash market instruments for hedging is the low capital commitment required. Unlike purchasing physical bonds or loans, which requires the full deployment of principal funds, derivatives typically involve only a small upfront margin or premium. This allows banks to manage large-scale market risks effectively without tying up significant liquidity.

50. (C) The difference between sources and uses of funds in specific time bands

In the framework of Asset Liability Management, a liquidity gap is a fundamental metric used to measure funding requirements. It is defined as the difference between the total sources of funds and the total uses of funds within specific time bands.

By calculating this gap for various periods, banks can identify potential shortfalls in cash flow and plan accordingly.

ANSWERS

1. (B) Self-Regulatory Organisations (SROs) such as FIMMDA and FEDAI

In the Indian financial landscape, specialized bodies known as Self-Regulatory Organisations maintain market integrity. Entities like the Fixed Income Money Market and Derivatives Association and the Foreign Exchange Dealers' Association of India represent various participants.

They are responsible for developing standardized codes of conduct and evolving market practices to ensure transparency and efficiency in settlement disputes.

2. (B) I, II, and IV only

Modern treasury functions integrate market risk management into core activities. The Asset Liability Management Committee is a pivotal decision-making body where the Treasury head serves as a vital member.

The specialized support group for this committee is typically embedded within the treasury team for seamless coordination. However, treasury heads actively contribute to product pricing rather than being barred.

3. (C) 120 months

Banks operate under specific regulatory guidelines concerning the duration of their deposit products. In the Indian banking sector, the maximum tenure for which a commercial bank can accept term deposits is traditionally fixed at ten years.

This duration corresponds to exactly one hundred and twenty months, providing a clear long-term horizon for individual and institutional savings strategies.

4. (D) Enter an interest rate swap to pay a fixed rate for 3 years and receive a floating rate linked to a benchmark

To protect the spread against rising market rates, the treasury can utilize an interest rate swap. By entering an agreement to pay a fixed rate for the three-year duration while receiving a floating rate linked to a benchmark, the bank effectively hedges its interest cost.

This strategy aligns the variable income from loans with fixed payout obligations.

5. (D) It manifests as liquidity and interest rate risks across the balance sheet.

Market risk in banking operations is a comprehensive concept that extends beyond the trading book to affect the entire balance sheet. It primarily manifests as liquidity risk and interest rate risk, arising from fluctuations in market variables.

Effective management requires monitoring these risks to ensure the bank maintains sufficient cash flow and protects its net interest income.

6. (D) I, II, and III

Treasury departments utilize various financial instruments to mitigate balance sheet mismatches and meet investor needs. These include floating rate loans linked to benchmarks, inflation-indexed government securities, and corporate debt containing embedded call or put options.

These structured products allow the bank to manage interest rate sensitivity while offering flexibility to investors with different risk appetites.

7. (B) Liquidity problem upon deposit maturity and reduction in net interest income

Maturity mismatches create significant vulnerabilities for a financial institution. When short-term deposits fund long-term fixed-rate mortgage loans, the bank faces potential liquidity problems when those deposits mature.

Additionally, if market interest rates rise during renewal, the bank suffers a reduction in net interest income because its cost of funds increases while its lending yield remains fixed.

8. (A) A developed derivative market and skilled dealers for accurate pricing.

The effective use of derivatives for managing asset-liability risks requires a sophisticated financial ecosystem. A well-developed derivative market is essential to provide liquidity and transparent pricing for various instruments.

Additionally, the bank must employ highly skilled dealers capable of accurately pricing

59. (B) I, III, and IV only

A standard credit default swap is a derivative instrument that segregates credit risk from the underlying loan or investment. It is linked to a reference asset, such as a corporate bond.

The protection buyer pays a periodic premium to the seller to mitigate exposure to potential credit events. Crucially, the protection seller, not the buyer, provides the guarantee to cover losses if default occurs.

60. (C) Suspicion of pressure can prompt a bank run, threatening its survival.

Banks prioritize short-term liquidity management because it is essential for maintaining public confidence. Even if a bank is profitable over the long term, any suspicion of financial pressure can quickly prompt a bank run.

This occurs when depositors rush to withdraw their balances immediately, threatening the bank's survival. Therefore, managing short-term liquidity is critical for ensuring operational continuity.

61. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Credit derivatives are considered highly leveraged instruments because they allow participants to gain significant exposure with minimal upfront cost.

The protection fee or credit default spread paid by the buyer is only a tiny fraction of the total notional value of the underlying credit. This small payment provides protection to a much larger principal amount, amplifying both gains and losses.

62. (C) Erosion of Net Interest Income (NII) due to market rate movements.

Interest Rate Risk is a critical concern for financial institutions, specifically defined in the context of their earnings performance.

It refers to the risk that adverse movements in market interest rates will lead to the erosion of the bank's Net Interest Income. This occurs when the rates on the bank's assets and liabilities do not adjust simultaneously or in the same proportion.

63. (D) Provident Funds : Permitted as Market-makers

The regulatory framework for Credit Default Swaps in India specifies which entities can participate and in what capacity. Commercial banks and standalone primary dealers are permitted to act as market-makers, providing liquidity.

Listed corporates are allowed to participate as users to hedge their risks. However, provident funds are restricted to acting only as users and are not permitted as market-makers.

64. (B) Only II

Measuring interest rate mismatches requires a focus on the sensitivity of instruments to rate changes. This is achieved by calculating the gap between rate-sensitive assets and rate-sensitive liabilities within specific time buckets.

This method accounts for interim interest rate changes rather than just final maturity dates, providing an accurate picture of how fluctuations in market rates impact the bank.

65. (B) Unlisted Retail Proprietorships

Eligibility to use Credit Default Swaps in India is restricted to specific institutional categories to ensure market stability. Recognized users include provident funds, foreign institutional investors, and listed corporates, who use these instruments for risk mitigation.

However, unlisted retail proprietorships are excluded from this group because they typically do not meet the scale or requirements necessary to participate in these derivatives.

66. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Repricing risk is a core component of interest rate management in banking. When a loan is repaid, the bank can only deploy those funds into fresh lending at current market rates, making that asset rate-sensitive.

In contrast, a fixed-rate bond maturing far in the future remains insensitive to interim market price changes. This difference in sensitivity creates gaps across time buckets.

Interest Expended

- (C) Subscriptions to papers and periodicals — Other Expenditure (Operating Expenses)
- (D) Transfer to contingencies — Provisions and Contingencies

May/June 2018

42. What is the fundamental definition of Asset Liability Management (ALM)?
- (A) The exclusive management of bank capital to ensure compliance with the Capital Adequacy Ratio (CAR).
 - (B) The process of directing fund flows to generate stable earnings and build equity over time.
 - (C) The process of eliminating market risks by matching the maturity dates of all deposits and advances.
 - (D) The strategic allocation of funds towards government securities to maintain the Statutory Liquidity Ratio.

Oct/Nov 2015

43. Consider the following statements regarding the balances held by banks:
- I. Funds transacted on an overnight basis are categorised under the call money market.
 - II. Surplus cash parked with RBI over and above CRR requirements is classified under Balances with Banks and Money at Call and Short Notice.
- Which of the above statement(s) is/are correct?
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

May/June 2022

44. How is the Net Interest Margin (NIM) mathematically defined?
- (A) Total Interest Income multiplied by Total Interest Expenses
 - (B) Total Interest Income minus Operating Expenses
 - (C) Net Interest Income divided by average total assets
 - (D) Total Assets divided by Net Interest Income

Oct/Nov 2009

45. Consider the following statements regarding the income of a bank:
- I. The net position appearing after the

revaluation of investments is considered under 'Profit on Revaluation of Investment', and any loss after netting is shown as a deduction.

- II. Income earned by way of dividends from joint ventures abroad is included under 'Profit on Exchange Transactions'.

Which of the above statement(s) is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

May/June 2014

46. In terms of the provisions of which section of the Banking Regulation Act 1949 shall commercial banks prepare a Balance Sheet and Profit and Loss account?
- (A) Section 15
 - (B) Section 24
 - (C) Section 29
 - (D) Section 42

Oct/Nov 2024

47. Consider the following items and identify which are correctly included under the Contingent Liabilities of a bank:
- I. Outstanding forward exchange contracts
 - II. Arrears of cumulative dividends
 - III. Inter-office adjustments (Credit balance)
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2008

48. On what date did the Government of India specify the Forms in the third schedule vide notification S.O. 240 (E) published in the Gazette of India?
- (A) March 31, 1949
 - (B) March 26, 1992
 - (C) April 1, 1999
 - (D) March 31, 2021

Oct/Nov 2018

49. Consider the following statements regarding the growing significance of ALM:
- I. Deregulation of the financial system has caused vagaries reflected in interest rate structures, exchange rates, and price levels.

the liquidity policy, the composite risk policy for treasury, and the general ALM policy itself.

However, the risk management policy for operational risk is typically excluded from the committee's purview, as it deals with internal processes rather than financial market variables.

76. (B) Only II

Hedging interest rate risk is challenging for Indian banks due to the structure of the local market. Most major participants, particularly large commercial banks, often have similar balance sheet profiles and tend to be on the same side of the market.

This lack of diverse counterparties willing to take opposite positions makes it difficult for institutions to seamlessly hedge their risks.

77. (B) I, II, and IV only

Market risk policies in banks must adhere to strict structural and regulatory standards. They require approval from the Board of Directors and must comply with industry standards evolved by self-regulatory organizations.

Additionally, these documents must be periodically reviewed and are typically filed with the regulator. They are not permanent documents and must reflect the current market and regulatory environment.

78. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Banks cannot realistically eliminate all asset-liability mismatches from their balance sheets because funds cannot be easily shifted across time bands.

Furthermore, managing these inherent mismatches is a primary way that banks generate profit. By acting as intermediaries and transforming maturities, banks earn a spread. Therefore, the goal of ALM is to manage risks within safe limits rather than removing them.

79. (B) I, II, III, and IV only

Treasury operations are governed by several distinct policies that form a comprehensive risk management framework. This landscape includes composite risk policies for foreign exchange, transfer pricing mechanisms, and hedging policies for customers.

It also incorporates anti-money laundering regulations. While credit risk management is vital, it is typically managed through a separate framework that is not under the treasury committee's direct purview.

80. (D) They are highly marketable, allowing quick liquidation to infuse cash.

Banks often choose to subscribe to commercial paper through their treasury departments rather than extending traditional loans due to the advantage of marketability.

Unlike standard bilateral loans, commercial papers are highly tradable financial instruments. This allows the bank to quickly liquidate these assets in the secondary market if they need to infuse cash, providing superior liquidity compared to illiquid credit facilities.

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Oct/Nov 2011

27. Which option best describes the ultimate objective of Asset Liability Management?
- (A) To generate stable earnings and build equity while taking measured business risks.
 - (B) To eliminate market risks by strictly fixing interest rates on all long-term loans.
 - (C) To convert all tangible assets into cash to maintain liquidity regardless of yield.
 - (D) To ensure that operating expenses remain lower than provisions and contingencies.

May/June 2009

28. Based on the maturity profile of Zenith Bank (60% liabilities maturing vs. 15% assets maturing within six months), what type of gap is established for this specific period according to price matching principles?
- (A) A positive gap (assets > liabilities)
 - (B) A neutral gap (assets = liabilities)
 - (C) A negative gap (liabilities > assets)
 - (D) A theoretical gap disconnected from maturity

Oct/Nov 2025

29. What is the primary management goal when Asset Liability Management views financial institutions as an integral system?
- (A) The strict elimination of all foreign exchange dealings to prevent currency mismatches.
 - (B) The control of interest margins and net income on an ongoing and systematic basis.
 - (C) The maximization of fixed asset accumulation to secure large-scale long-term borrowing.
 - (D) The conversion of all non-performing assets into long-term equity holdings for the bank.

May/June 2007

30. Read the following scenario regarding Horizon Bank and answer the questions that follow:
Horizon Bank recently experienced a market shock. Due to a sudden economic event, a large volume of depositors utilized their embedded options to prematurely withdraw their term deposits.
 What specific risk did Horizon Bank face because of this depositor action?
- (A) Foreign Exchange Risk
 - (B) Credit Risk
 - (C) Refinancing Risk
 - (D) Reinvestment Risk

Oct/Nov 2008

31. Why is Capital considered a vital component of a bank's liabilities?
- (A) It represents short-term funds exclusively reserved for daily cash withdrawals
 - (B) It provides the primary channel for inter-office adjustments between domestic branches
 - (C) It is utilized exclusively for generating fee income and brokerage
 - (D) It serves as a cushion for depositors and creditors to fall back in case of losses

May/June 2016

32. As a direct consequence of the premature withdrawal of term deposits by customers, what immediate action is forced upon Horizon Bank regarding its balance sheet management?
- (A) It must permanently write off an equivalent amount of fixed assets.
 - (B) It must immediately transfer funds from capital reserves to the profit and loss account.
 - (C) It must redeploy the funds received into lower-yielding securities or government bonds.
 - (D) It must replace the outgoing deposit with another to refinance assets at potential new costs.

Oct/Nov 2017

33. Arrange the following components of the 'Application of Funds' side of a bank's balance sheet in the order they sequentially appear:
- I. Fixed Assets
 - II. Balances with Banks and Money at Call and Short Notice
 - III. Advances
 - IV. Cash In Hand and Balance with RBI
- (A) IV, II, III, I
 - (B) I, IV, III, II
 - (C) IV, III, II, I
 - (D) II, IV, I, III

May/June 2015

34. Apex Bank has also paid its annual premium to the Deposit Insurance and Credit Guarantee Corporation (DICGC). Under which sub-category of 'Operating Expenses' must this payment be recorded?
- (A) Payments to and Provisions for Employees
 - (B) Rent, Taxes and Lighting

May/June 2025

8. Consider the following statements regarding the objectives of Asset Liability Management:
- At the macro-level, ALM leads to the formulation of critical business policies and efficient allocation of capital.
 - At the micro-level, ALM aims at profitability through price matching.
 - At the micro-level, ALM ensures liquidity by grouping assets and liabilities randomly without maturity matching.
- Which of the above statement(s) is/are correct?
- I and II only
 - II and III only
 - I and III only
 - I, II, and III

Oct/Nov 2010

9. Under which specific category does the credit balance of the net inter-office adjustments fall on a bank's balance sheet?
- Other Liabilities and Provisions
 - Reserves and Surplus
 - Other Assets
 - Contingent Liabilities

May/June 2013

10. Consider the following statements regarding the embedded options in assets and liabilities:
- Depositors having an option to seek premature repayment causes Refinancing Risk.
 - Borrowers having the option of prepayment of their borrowing leads to Reinvestment Risk.
 - Refinancing risk requires a bank to replace the outgoing deposit with another deposit, potentially at a different cost.
- Which of the above statement(s) is/are correct?
- I and II only
 - II and III only
 - I and III only
 - I, II, and III

Oct/Nov 2016

11. What does a positive gap in price matching indicate for an institution?
- The position where assets exceed liabilities, allowing the bank to benefit from rising interest rates.
 - The position where liabilities exceed assets, allowing the bank to benefit from falling

interest rates.

- The position where an institution is strategically set to benefit from declining interest rates.
- The strategy of matching all rate-sensitive items to eliminate market risk within the portfolio.

May/June 2005

12. Consider the following statements about 'Advances' on a bank's balance sheet:
- They represent the credit extended by a bank to its customers and are a major source of income.
 - Term loans will not become payable on demand and are mostly repaid in EMIs.
 - Bills purchased and discounted include only foreign bills, excluding domestic bills.
 - Unsecured advances do not have any tangible security and are not covered by bank/government guarantees.
- Which of the above statement(s) is/are correct?
- I, II, and III
 - I, II, and IV
 - II, III, and IV
 - I, III, and IV

Oct/Nov 2022

13. Asset Liability Management views financial institutions as what type of system?
- A set of independent business units that operate without establishing mutual financial linkages.
 - A set of interrelationships that must be identified and managed as an integral system.
 - A highly segregated framework where assets and liabilities are strictly and legally isolated.
 - A rigid legal structure governed exclusively by fixed and mandatory statutory reserve policies.

May/June 2019

14. Consider the following statements regarding 'Cash and Balances with RBI':
- It forms the most liquid account held by any bank.
 - It includes foreign currency notes.
 - It includes cash balances in the overseas branches of the bank.
 - It includes balances held with RBI to meet

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statutory cash reserve requirements (CRR).

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, III, and IV

Oct/Nov 2007

15. Which statement correctly identifies an item classified under Other Assets?
- (A) Overdrafts and Loans Repayable on Demand
 - (B) Borrowings obtained from EXIM Bank of India
 - (C) Outstanding forward exchange contracts
 - (D) Non-Banking Assets Acquired in Satisfaction of Claims

May/June 2021

16. Consider the following items and identify which represent 'Interest Expended' in a bank's Profit and Loss Account:
- I. Interest paid on all types of deposits raised by the bank.
 - II. Discount/interest on all borrowings/refinance from RBI.
 - III. Penal interest paid on borrowings from Financial Institutions.
 - IV. Bad and doubtful debts provisions.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
 - (B) I, II, and IV
 - (C) II, III, and IV
 - (D) I, III, and IV

Oct/Nov 2005

17. Which statement correctly categorises income derived from godown rents and the bank's properties?
- (A) It is classified under Profit on Sale or Investments
 - (B) It is classified under Miscellaneous Income
 - (C) It is classified under Income Earned by Way of Dividends
 - (D) It is classified under Commission, Exchange and Brokerage

May/June 2011

18. Consider the following statements regarding the structure of Advances:
- I. Cash credits and Overdrafts are categorized as repayable on demand.
 - II. Advances covered by guarantees of DICGC

are treated as covered by Bank/Government Guarantees.

- III. Advances secured by tangible assets outside India are considered secured assets.
- IV. Bills discounted are classified entirely separately from standard term loans and demand loans.
- V. Term loans generally have a specific due date.

Which of the above statement(s) is/are correct?

- (A) I, II, IV, and V
- (B) I, III, IV, and V
- (C) II, III, IV, and V
- (D) I, II, III, IV, and V

Oct/Nov 2020

19. Which statement regarding the components of a bank's assets is incorrect?
- (A) Surplus cash parked with RBI above CRR requirements is classified under Fixed Assets.
 - (B) Advances represent credit extended to customers and form a major part of the assets.
 - (C) The cash in hand item includes foreign currency notes and balances in overseas branches.
 - (D) Investments include approved securities, shares, debentures, and various types of bonds.

May/June 2017

20. Consider the following statements regarding the growing significance of Asset Liability Management:
- I. Deregulation has led to volatility in interest rate structures and money supply.
 - II. Bank for International Settlements (BIS) provides frameworks to tackle market risks.
 - III. Financial products undergo rapid innovations, impacting the bank's risk profile.
 - IV. There is increasing awareness in top management that the risks of banking have changed.
 - V. The Reserve Bank of India strictly prohibited the formation of asset and liability committees within financial institutions.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV
 - (B) I, II, III, and V
 - (C) II, III, IV, and V

(D) I, III, IV, and V

Oct/Nov 2012

21. Which statement regarding a bank's operating expenses is incorrect?
- (A) Rent, Taxes and Lighting excludes income tax and interest tax.
 - (B) Payments to and Provisions for Employees include leave fare concession and medical allowance.
 - (C) Director's fees, Allowances and Expenses relate to sitting fees and other expenditure incurred on behalf of directors.
 - (D) Insurance expense excludes the premium paid to Deposit Insurance and Credit Guarantee Corporation (DICGC).

May/June 2006

22. For the following questions, two statements are given—one labelled Assertion (A) and the other labelled Reason (R). Select the correct answer from the codes (A), (B), (C), and (D) as given below:
- Assertion (A): Asset Liability Management (ALM) is considered one of the most important risk-management functions in banking.
- Reason (R): The business of banking fundamentally involves identifying, measuring, accepting, and managing risk.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2014

23. All of the following are classified under 'Other Liabilities and Provisions' EXCEPT:
- (A) Drafts, telegraphic transfers, and travellers cheques
 - (B) Statutory reserves, capital reserves, and share premium
 - (C) Credit balance of the net inter-office adjustments
 - (D) Provision for income tax and tax deducted at source

May/June 2010

24. For the following questions, two statements are given—one labelled Assertion (A) and the other labelled Reason (R). Select the correct answer from the codes (A), (B), (C), and (D) as given below:
- Assertion (A): An institution having a negative gap is in a position to benefit from rising interest rates.
- Reason (R): A negative gap occurs when an institution's liabilities exceed its assets based on their maturing profiles.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2006

25. All of the following are categorized as Fixed Assets on a bank's balance sheet EXCEPT:
- (A) Stock of stationery on hand
 - (B) Immovable properties
 - (C) Furniture and fixtures
 - (D) Motor vehicles and hardware

May/June 2023

26. For the following questions, two statements are given—one labelled Assertion (A) and the other labelled Reason (R). Select the correct answer from the codes (A), (B), (C), and (D) as given below:
- Assertion (A): Surplus cash parked with RBI over and above CRR requirements is accounted for under the 'Cash in Hand and Balance with RBI' asset category.
- Reason (R): Banks hold these surplus cash balances with RBI specifically to meet emergency funding requirements.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

- 67. (A) The ISDA Master Agreement for Credit Derivatives**

Global transactions involving credit derivatives are governed by a standardized legal framework to ensure consistency. The International Swaps and Derivatives Association Master Agreement provides the necessary covenants and protocols for these complex contracts.

This widely recognized framework allows market participants to execute transactions with a clear understanding of their rights and obligations across different jurisdictions and financial segments.

- 68. (D) Swapping the fixed rate to a floating rate using derivative instruments**

To address a repricing mismatch where liabilities are floating and assets are fixed, the treasury can use derivative instruments.

By swapping the fixed interest rate on its assets to a floating rate, the bank aligns its income with its variable interest expenses. This strategy effectively reduces interest rate risk and protects the net interest margin from fluctuations in market-determined borrowing costs.

- 69. (D) Tradable bonds offer an easy exit if the issuer's credit quality declines.**

A primary reason treasury departments supplement credit portfolios with corporate bonds is the advantage of marketability. Unlike traditional bilateral loans, which are relatively illiquid, tradable bonds can be sold in the secondary market.

This provides the bank with an easy exit option if the issuer's credit quality begins to decline, allowing for quicker fund recovery than through standard loan recovery.

- 70. (C) Prematurely extend deposits at higher rates, nullifying bank benefits.**

In the Indian banking market, depositors often take advantage of rising interest rates by prematurely extending their fixed deposits.

By paying a small penalty to close an old deposit and immediately reopening it at the new, higher rate, they secure better returns. This behavior nullifies the bank's potential benefit from rising rates and forces the institution to pay higher interest costs.

- 71. (B) Credit risk, net of mismatches in sources and uses of funds.**

Under a transfer pricing framework, the treasury notionally buys deposits and sells loans to retail branches at market-linked prices. This mechanism effectively transfers liquidity and interest rate risks from the branches to the centralized treasury.

Consequently, the remaining profitability of a retail branch genuinely reflects its management of credit risk, separated from broader market variables and statutory reserve requirements.

- 72. (B) I and III only**

The Marginal Cost of Funds based Lending Rate system functions as a floating interest rate for bank advances. In a falling interest rate scenario, the bank's net interest margin typically contracts. This occurs because advances are repriced downwards more quickly than the costs of retail deposits, which often remain locked in at higher fixed rates, leading to a temporary squeeze on earnings.

- 73. (A) Only I**

Transfer pricing is an essential tool in multi-branch banking for accurately assessing the performance of individual units. By setting internal prices for funds, the bank can evaluate branch profitability independently of market fluctuations.

These transfer prices are not identical for all products; instead, they vary based on the specific tenor and maturity of deposits and loans to reflect their unique risks.

- 74. (B) 1st April 2016**

The Reserve Bank of India implemented a significant change in the way banks price their loans by introducing the Marginal Cost of Funds based Lending Rate system.

This framework was designed to improve the transmission of policy rates into lending rates. The system became mandatory for all commercial banks for pricing their advances starting from the first of April in twenty sixteen.

- 75. (A) Risk Management Policy for Operational Risk**

The Asset Liability Management Committee oversees several specialized policy components that impact a bank's market risk. These include

- (C) Insurance
- (D) Other Expenditure

Oct/Nov 2013

35. Match the Operating Expenses categories in List I with their corresponding descriptions in List II and select the correct answer using the codes given below:

List I: Operating Expenses

- P. Printing and Stationery
- Q. Rent, Taxes and Lighting
- R. Depreciation on Bank's Property
- S. Law Charges

List II: Descriptions

1. Municipal taxes and other charges on electricity
 2. All legal expenses and reimbursement of related expenses
 3. Books and forms used by the bank not incurred by way of publicity
 4. Value reduction on leasehold properties and electric fittings
- (A) P-3, Q-1, R-4, S-2
 - (B) P-1, Q-3, R-2, S-4
 - (C) P-4, Q-2, R-1, S-3
 - (D) P-3, Q-4, R-2, S-1

May/June 2024

36. Pinnacle Bank has extended a large commercial loan to a manufacturing firm, which is entirely secured by the firm's warehouse machinery and factory premises. Under which specific category of Advances should Pinnacle Bank classify this loan?
- (A) Covered by Bank/Government Guarantees
 - (B) Unsecured Advances
 - (C) Bills Purchased and Discounted
 - (D) Secured by Tangible Assets

Oct/Nov 2021

37. Match the ALM parameters in List I with their formulas or definitions in List II and select the correct answer using the codes given below:

List I: ALM Parameters

- P. Net Interest Income (NII)
- Q. Net Interest Margin (NIM)
- R. Economic Equity Ratio
- S. Stage 2 Profit

List II: Formulas or Definitions

1. Net Interest Income divided by average total assets
2. Interest Income - Interest Expenses

3. Ratio of the shareholders' funds to the total assets
 4. Interest Income - Interest expense - provision for loan loss + non-interest revenue - non-interest expense - taxes
- (A) P-2, Q-1, R-3, S-4
 - (B) P-1, Q-2, R-4, S-3
 - (C) P-3, Q-4, R-1, S-2
 - (D) P-2, Q-3, R-4, S-1

May/June 2012

38. Pinnacle Bank provides a personal loan to a retail customer without holding any tangible security or receiving any guarantees from a government or banking entity. How is this loan categorized on the balance sheet?
- (A) Secured by Tangible Assets
 - (B) Covered by Bank/Government Guarantees
 - (C) Unsecured Advances
 - (D) Fixed Assets

Oct/Nov 2019

39. Which of the following pairs correctly matches a balance sheet management function with its respective side?
- (A) Capital Management — Asset side Management
 - (B) Reserve position management — Both Asset side and Liability side Management
 - (C) Loan Management — Liability side Management
 - (D) Fixed-Assets Management — Liability side Management

May/June 2020

40. The ALCO of Nexus Bank shifts its focus to formulating policies aimed at generating fee income and controlling non-interest operating expenses to boost overall profitability. Under which stage does this specific task fall?
- (A) Stage 2: Income-Expense Functions
 - (B) Stage 1: Balance Sheet Functions
 - (C) Stage 3: Long-Term Management
 - (D) Stage 4: Margin Stabilisation

Oct/Nov 2023

41. Which of the following pairs incorrectly matches a transaction to its Profit and Loss Account classification?
- (A) Profit on revaluation of investment — Interest Income
 - (B) Interest on participation certificates —

CHAPTER 26

Components and Management of Assets and Liabilities in Banks' Balance Sheets

Oct/Nov 2015

1. While operating within Stage 2 (Income-Expense Functions), Nexus Bank must formulate policies to achieve multiple objectives. Which of the following is also explicitly listed as a core objective under this stage?
- (A) Reserve position management
 - (B) Spread Management
 - (C) Fixed-Assets Management
 - (D) Management of Notes and Debentures

May/June 2022

2. Which of the following pairs incorrectly matches an advance type to its classification category?
- (A) Advances secured by guarantees of foreign governments — Covered by Bank/Government Guarantees
 - (B) Advances without any security — Unsecured Advances
 - (C) Advances secured by tangible assets within India — Fixed Assets
 - (D) Cash credits and Overdrafts — Advances Repayable on Demand

Oct/Nov 2009

3. Under which timeframe are funds transacted in the notice money market?
- (A) For a period between 2 days and 14 days
 - (B) On an overnight basis
 - (C) For a period of exactly 15 days to 30 days
 - (D) For a period exceeding one month up to one year

May/June 2014

4. Consider the following statements regarding a bank's balance sheet:
- I. A bank's obligations under the issuance of letters of credit and guarantees on behalf of constituents are reflected under contingent liabilities.
 - II. Non-banking assets acquired in satisfaction of claims are reflected under fixed assets.

Which of the above statement(s) is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2024

5. What is the definition of the Economic Equity Ratio?
- (A) The ratio of total borrowed funds to the total capital of the bank
 - (B) The ratio of operating expenses to the total interest income
 - (C) The ratio of net profit to the total liabilities
 - (D) The ratio of the shareholders' funds to the total assets

May/June 2008

Consider the following statements regarding ALM concepts:

- I. Asset-liability management can be performed on a per-liability basis by matching a specific asset to support each liability.
- II. The Economic Equity Ratio assesses the sustenance capacity of the bank.

Which of the above statement(s) is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2018

7. In which schedule of the Banking Regulation Act 1949 are the forms for the Balance Sheet and Profit and Loss account set out?
- (A) First Schedule
 - (B) Second Schedule
 - (C) Third Schedule
 - (D) Fourth Schedule

NODIA

II. Innovations like 'old wine in a new bottle' have no impact on the risk profile of the bank.

III. There is increasing awareness in top management that banking is now a different game altogether since all risks of the game have changed.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2025

50. What core dynamic causes a bank to face Refinancing Risk?

- (A) Borrowers deciding to prepay their borrowing to take advantage of lower interest rates
- (B) The central bank imposing higher cash reserve requirements without prior notice
- (C) Depositors exercising their option to seek premature repayment of their deposit
- (D) Immovable properties depreciating faster than the projected accounting estimates

Oct/Nov 2010

51. Consider the following policies and identify which are implemented to achieve the Stage 2 objectives of Asset Liability Management:

- I. Generating fee income and service charges
- II. Tax Management
- III. Capital Adequacy

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2013

52. How is the Net Interest Margin (NIM) conceptually viewed in the context of earning assets?

- (A) As the default risk premium on long-term assets
- (B) As the total tax shield derived from earning assets
- (C) As the unadjusted gross return on capital invested
- (D) As the 'Spread' on earning assets

Oct/Nov 2016

53. Consider the following items and identify which are categorised under 'Other Income' in a bank's Profit and Loss Account:

- I. Rent on lockers
- II. Profit on dealings in foreign exchange
- III. Interest earned on balances with RBI
- IV. Recoveries from constituents for godown rents

Which of the above statement(s) is/are correct?

- (A) I, II, and IV
- (B) I, III, and IV
- (C) II, III, and IV
- (D) I, II, III, and IV

May/June 2005

54. Which statement correctly identifies an item classified under Contingent Liabilities?

- (A) Tax deducted at source on securities and advance tax paid
- (B) Share premium and revenue reserves
- (C) Claims against the bank not acknowledged as debts
- (D) Balances in current accounts with other banks

Oct/Nov 2022

55. Consider the following statements regarding the features of ALM:

- I. It is concerned with strategic balance sheet management.
- II. Its primary goal is to completely avoid all risks to sustain profitability.
- III. It requires the ability to anticipate, forecast and act so as to maximise the bank's business to profit.
- IV. It involves altering the assets and liabilities portfolio in a dynamic way.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, III, and IV
- (C) II, III, and IV
- (D) I, II, III, and IV

May/June 2019

56. Which statement accurately describes the objective of price matching at the micro-level?

- (A) Deploying liabilities at rates higher than their costs to maintain interest spreads.
- (B) Grouping assets and liabilities based on maturity profiles to mitigate liquidity risk.
- (C) Equalising the volume of secured advances

with the volume of unsecured advances.

- (D) Matching the legal tenure of every deposit with the tenure of a corresponding asset.

Oct/Nov 2007

57. Consider the following items listed under the expenses of a bank:
- I. Leave fare concession and staff welfare allowances.
 - II. Cost of books, forms, and stationery not incurred by way of publicity.
 - III. Sitting fees incurred on behalf of directors.
 - IV. Postage expenditures and courier charges for dispatching envelopes.
 - V. Diminution in the value of investments.
- Which of the above statement(s) is/are correctly classified as 'Operating Expenses'?
- (A) I, II, III, and IV
 - (B) I, II, IV, and V
 - (C) I, III, IV, and V
 - (D) II, III, IV, and V

May/June 2021

58. Which statement regarding the components of a bank's liabilities is incorrect?
- (A) Capital serves as a cushion for depositors and creditors to fall back in case of losses.
 - (B) Capital represents the owners' stake and is considered a short-term source of funds.
 - (C) Borrowings in India consist of refinancing obtained from the RBI and entities like NABARD.
 - (D) Deposits are broadly classified as demand deposits, savings deposits, and term deposits.

Oct/Nov 2005

59. Consider the following items and identify which fall under the category of 'Other Liabilities and Provisions':
- I. Mail transfers payable and pay slips.
 - II. The debit balance of the net inter-office adjustments.
 - III. Interest accrued but not due on deposits and borrowings.
 - IV. Provision for income tax and tax deducted at source.
 - V. Interest tax and other provisions.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV
 - (B) I, III, IV, and V
 - (C) II, III, IV, and V

- (D) I, II, IV, and V

May/June 2011

60. Which statement regarding the specific balance sheet management functions is incorrect?
- (A) Liability side management includes Reserve Position Management.
 - (B) Asset side management includes Investment/Security Management.
 - (C) Liability side management includes Fixed-Assets Management.
 - (D) Liability side management includes Long-Term Management of Notes and Debentures.

Oct/Nov 2020

61. Consider the following management functions and identify which are explicitly listed as Asset side Management functions:
- I. Reserve position management
 - II. Liquidity management
 - III. Investment/Security Management
 - IV. Loan Management
 - V. Fixed-Assets Management
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV
 - (B) II, III, IV, and V
 - (C) I, II, IV, and V
 - (D) I, II, III, IV, and V

May/June 2017

62. All of the following are components of operating expenses for a bank EXCEPT:
- (A) Postage expenditure converted into courier charges
 - (B) Depreciation on bank's own property and non-banking assets
 - (C) Discount/interest on all borrowings/refinance from RBI
 - (D) Auditors' Fees paid to statutory/branch auditors

Oct/Nov 2012

63. For the following questions, two statements are given—one labelled Assertion (A) and the other labelled Reason (R). Select the correct answer from the codes (A), (B), (C), and (D) as given below:
- Assertion (A): When borrowers exercise the option to prepay their borrowing, it leads to Refinancing Risk for the bank.
- Reason (R): The bank must find an alternative opportunity to redeploy the received funds,

potentially at a different rate of interest.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2006

64. All of the following items are classified under 'Other Income' in a bank's Profit and Loss account EXCEPT:
- (A) Profit/loss on dealings in foreign exchange
 - (B) Rent on lockers and commission or exchange earned on various remittances.
 - (C) Profit/loss on sale of furniture, land and buildings
 - (D) Dividend and interest income earned on the investment portfolio of the bank.

Oct/Nov 2014

65. For the following questions, two statements are given—one labelled Assertion (A) and the other labelled Reason (R). Select the correct answer from the codes (A), (B), (C), and (D) as given below:
- Assertion (A): Greater spreads maintained between total interest income and total interest expense only imply enhanced risk exposure.
- Reason (R): There exists a direct correlation between risks and return in the business of banking.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2010

66. All of the following are Income-Expense function objectives of Asset Liability Management EXCEPT:
- (A) Spread Management
 - (B) Generating fee income and service charges
 - (C) Liquidity management
 - (D) Control of non-interest operating expenses

Oct/Nov 2006

67. Read the following scenario regarding Zenith Bank and answer the questions that follow:
- Zenith Bank has completed a maturity profile analysis and found that 60% of its liabilities mature within the next six months, while only 15% of its assets will mature in the same period. Even though the bank has enough total assets over the long term, what immediate crisis might Zenith Bank face due to this mismatch?*
- (A) A liquidity crisis that renders the bank temporarily or technically insolvent.
 - (B) A severe credit risk crisis resulting from widespread customer loan defaults.
 - (C) An abrupt decline in its economic equity ratio due to a loss of total assets.
 - (D) Immediate intervention by the ECGC for guarantee failures on its fixed loans.

May/June 2023

68. Which option best describes the strategy of balance sheet restructuring?
- (A) Converting all physical branch locations into digital platforms to reduce fixed assets.
 - (B) Bank managers aggressively discounting bills to artificially inflate daily cash balances.
 - (C) Shifting all unadjusted debit balances to contingent liabilities to clear the balance sheet.
 - (D) Managing asset and liability composition in response to corporate goals and conditions.

Oct/Nov 2011

69. If the market interest rates are projected to decline significantly during the six-month period, how will Zenith Bank's negative gap position affect its institutional standing, assuming immediate repricing?
- (A) The institution will face catastrophic yield compression and massive losses.
 - (B) The institution will immediately breach the Statutory Liquidity Ratio (SLR).
 - (C) The net interest margin will remain entirely unaffected by the rate decline.
 - (D) The institution is in a position to benefit from the declining interest rates.

May/June 2009

70. How is liquidity ensured at the micro-level of Asset Liability Management?
- (A) By increasing the capital adequacy ratio to a level significantly exceeding total advances.

- (B) By permanently freezing the issuance of new letters of credit and financial guarantees.
- (C) By grouping assets and liabilities based on maturing profiles to identify financing needs.
- (D) By converting all demand deposits into ten-year term deposits to stabilize the bank funds.

Oct/Nov 2025

71. During the same period, market interest rates dropped, and many of Horizon Bank's corporate borrowers decided to prepay their high-interest term loans entirely. What specific risk materialised for the bank due to this borrower action?
- (A) Operational Risk
 - (B) Reinvestment Risk
 - (C) Refinancing Risk
 - (D) Inter-office Adjustment Risk

May/June 2007

72. Arrange the following steps involved in the process of quantifying and managing risks in Asset Liability Management in the correct sequential order:
- I. Reviewing the interest rate structure and comparing the same to the interest/product pricing of both assets and liabilities.
 - II. Examining the loan and investment portfolios in the light of the foreign exchange risk and liquidity risk.
 - III. Examining the credit risk and contingency risk that may originate due to rate fluctuations and assess the quality of assets.
 - IV. Reviewing the actual performance against the projections made and analysing the reasons for any effect on the spreads.
- (A) II, I, IV, III
 - (B) I, II, III, IV
 - (C) III, II, I, IV
 - (D) I, III, II, IV

Oct/Nov 2008

73. The accounting department of Apex Bank is finalising the annual Profit and Loss Account. They have received revenue from rent collected on customer lockers. Under which specific head of 'Other Income' should this revenue be classified?
- (A) Commission, Exchange and Brokerage
 - (B) Miscellaneous Income

- (C) Profit on Sale of Land, Building and Other Assets
- (D) Income on Investments

May/June 2016

74. Match the Sources of Funds categories in List I with their corresponding items in List II and select the correct answer using the codes given below:

List I: Sources of Funds

- P. Capital
- Q. Reserve and Surplus
- R. Deposits
- S. Borrowings

List II: Corresponding Items

1. Current deposits and savings bank deposits
 2. Refinance obtained from NABARD
 3. Owners' stake serving as a cushion
 4. Share premium and balance in profit and loss account
- (A) P-3, Q-4, R-1, S-2
 - (B) P-4, Q-3, R-2, S-1
 - (C) P-1, Q-2, R-4, S-3
 - (D) P-3, Q-1, R-4, S-2

Oct/Nov 2017

75. Due to a market downturn, Apex Bank noted a significant diminution in the value of its investment portfolio. Under which major category of the bank's expenses will this value diminution be accounted for?
- (A) Provisions and Contingencies
 - (B) Interest Expended
 - (C) Operating Expenses
 - (D) Fixed-Assets Management

May/June 2015

76. Match the Other Assets components in List I with their corresponding descriptions in List II and select the correct answer using the codes given below:

List I: Other Assets Components

- P. Interest Accrued
- Q. Non-Banking Assets Acquired in Satisfaction of Claims
- R. Others (Other Assets)
- S. Tax Paid in Advance

List II: Descriptions

1. Tangible assets acquired against claims on others
2. Interest due, but not collected on investments

3. Amount of advance tax paid not set-off against relative tax provisions
 4. Clearing items and unadjusted debit balances representing additions to assets
- (A) P-2, Q-1, R-4, S-3
(B) P-1, Q-2, R-3, S-4
(C) P-3, Q-4, R-1, S-2
(D) P-4, Q-3, R-2, S-1

Oct/Nov 2013

77. Pinnacle Bank extends another credit facility to an exporter. This particular facility is not backed by tangible assets but is fully backed by a guarantee from the Export Credit Guarantee Corporation (ECGC). How should this advance be classified?
- (A) Secured by Tangible Assets
(B) Covered by Bank/Government Guarantees
(C) Unsecured Advances
(D) Non-Banking Assets Acquired in Satisfaction of Claims

May/June 2024

78. Match the ALM concepts and risks in List I with their scenarios in List II and select the correct answer using the codes given below:
- List I: ALM Concepts and Risks
- P. Refinancing Risk
Q. Reinvestment Risk
R. Positive gap
S. Negative gap
- List II: Scenarios
1. Borrowers opting to prepay their borrowing
 2. Depositors seeking premature repayment of their deposit
 3. Institution is in a position to benefit from declining interest rates
 4. Institution is in a position to benefit from rising interest rates
- (A) P-2, Q-1, R-4, S-3
(B) P-1, Q-2, R-3, S-4
(C) P-4, Q-3, R-1, S-2
(D) P-3, Q-4, R-2, S-1

Oct/Nov 2021

79. Read the following scenario regarding Nexus Bank and answer the questions that follow:
- The Asset Liability Management Committee (ALCO) of Nexus Bank is undertaking tasks based on a two-stage approach to balance sheet financial management. They are currently focusing on managing the bank's reserve position*

and overall liquidity on the asset side.

According to the ALM framework, this task falls under which stage?

- (A) Stage 2: Income and Expense Management Functions
(B) Stage 3: Strategic Corporate Profit Planning
(C) Stage 4: Capital Adequacy Requirement Implementation
(D) Stage 1: Specific Balance Sheet Management Functions

May/June 2012

80. Which of the following pairs correctly matches a balance sheet item to its primary classification?
- (A) Overdue deposits — Contingent Liabilities
(B) Provision for income tax and tax deducted at source — Reserves and Surplus
(C) Remittances and transfers brokerage — Interest Income
(D) Unadjusted debit balances representing deductions from liabilities — Other Assets

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diverse revenue streams supporting the bank's overall profitability.

18. (D) I, II, III, IV, and V

Advances are categorized by their nature, security, and location. Cash credits and overdrafts are repayable on demand, while term loans have specific due dates. Security-wise, advances can be secured by tangible assets within or outside India, or covered by guarantees such as those from DICGC. Bills discounted are also distinguished as a separate category, providing a comprehensive classification framework.

19. (A) Surplus cash parked with RBI above CRR requirements is classified under Fixed Assets
Surplus cash parked with the central bank beyond mandatory reserve requirements is not a fixed asset. Instead, it is classified under cash in hand and balances with the Reserve Bank of India. Fixed assets specifically include physical property, furniture, and equipment used in operations. Correct classification is necessary to distinguish between liquid monetary assets and long-term capital assets used for business.

20. (A) I, II, III, and IV

The importance of asset-liability management has grown due to financial deregulation, interest rate volatility, and rapid product innovation. Frameworks provided by the Bank for International Settlements also drive this significance. Top management now recognizes that banking risks have fundamentally changed. Regulatory bodies generally encourage, rather than prohibit, the formation of committees to manage these complex financial risks and maintain stability.

21. (D) Insurance expense excludes the premium paid to Deposit Insurance and Credit Guarantee Corporation (DICGC).

Insurance expenses for a bank include various premiums paid to mitigate operational and credit risks. Specifically, the annual premium paid to the Deposit Insurance and Credit Guarantee Corporation is a mandatory cost categorized under this heading. Excluding this premium from the insurance classification is incorrect, as it represents a significant and standard operating expense for commercial banking institutions in India.

22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Asset-liability management is a vital risk-management function because the core business of banking revolves around managing various financial risks. By identifying, measuring, and accepting risk, banks can stabilize their earnings and protect their capital base. Since banking inherently involves financial intermediation and maturity transformation, managing the relationship between assets and liabilities is the primary mechanism for ensuring institutional survival.

23. (B) Statutory reserves, capital reserves, and share premium

Other liabilities and provisions include items such as unpaid drafts, telegraphic transfers, and the credit balance of net inter-office adjustments. It also encompasses provisions for income tax and tax deducted at source. However, statutory reserves, capital reserves, and share premium represent the bank's own equity and retained earnings, which are classified separately under the reserves and surplus category.

24. (D) Assertion (A) is false, but Reason (R) is true.
A negative gap occurs when rate-sensitive liabilities exceed rate-sensitive assets within a specific time period. In such a position, the institution is set to benefit from falling interest rates, not rising ones. If rates rise, the cost of liabilities increases faster than the yield on assets, leading to a compressed margin. Thus, the assertion regarding benefiting from rising rates is incorrect.

25. (A) Stock of stationery on hand

Fixed assets on a bank's balance sheet consist of long-term physical assets used for business operations, including immovable properties, furniture, and motor vehicles. While hardware and electrical fittings are also included, the stock of stationery on hand is typically classified as a current asset or under other assets. It does not represent a capital investment intended for long-term operational use.

9. (A) Other Liabilities and Provisions

A bank's balance sheet includes various accounts to manage internal transactions between branches. When the net result of inter-office adjustments is a credit balance, it is classified under other liabilities and provisions. Conversely, a net debit balance would be categorized under other assets. This ensures that internal discrepancies are accounted for without affecting the core capital or reserves.

10. (D) I, II, and III

Embedded options in bank products create specific financial risks. When depositors seek premature repayment, the bank faces refinancing risk, often requiring the replacement of funds at current market costs. If borrowers prepay loans, the bank encounters reinvestment risk, needing to redeploy funds potentially at lower rates. Managing these options is a fundamental aspect of comprehensive asset-liability management strategies.

11. (A) The position where assets exceed liabilities, allowing the bank to benefit from rising interest rates.

A positive gap occurs when an institution's rate-sensitive assets exceed its rate-sensitive liabilities within a specific period. This strategic position allows the bank to benefit from rising interest rates, as more assets will be repriced at higher yields compared to the liabilities. Effective gap management is essential for stabilizing and potentially increasing the net interest margin over time.

12. (B) I, II, and IV

Advances represent credit extended to customers and serve as a primary income source. Term loans are typically repaid in installments and are not payable on demand. Unsecured advances are those lacking tangible security or government guarantees. However, bills purchased and discounted include both domestic and foreign bills, making the exclusion of domestic bills an incorrect classification in banking.

13. (B) A set of interrelationships that must be identified and managed as an integral system. Asset-liability management treats a financial institution as an integrated system rather than a collection of independent units. It focuses on

the complex interrelationships between various assets and liabilities. The goal is to coordinate these components as an integral system to manage risks and stabilize earnings. This holistic approach allows management to optimize interest margins and achieve long-term growth.

14. (D) I, II, III, and IV

The cash in hand and balance with RBI category represents a bank's most liquid assets. It includes physical currency, foreign currency notes, and balances held in overseas branches. Furthermore, it accounts for the mandatory balances maintained with the central bank to satisfy statutory cash reserve requirements. These components are vital for ensuring the bank can meet its immediate liquidity obligations.

15. (D) Non-Banking Assets Acquired in Satisfaction of Claims

Other assets encompass various items that do not fit into primary categories like advances or investments. Non-banking assets acquired in satisfaction of claims, such as property or equipment taken over from defaulting borrowers, fall under this classification. Other examples include interest accrued but not collected, advance tax payments, and unadjusted debit balances arising from inter-branch or clearing transactions.

16. (A) I, II, and III

Interest expended refers to the costs incurred by a bank to acquire funds for its operations. This includes interest paid on various customer deposits and discount or interest on borrowings and refinance from the central bank. Penal interest paid on borrowings from financial institutions is also included. However, provisions for bad debts are classified separately under provisions and contingencies.

17. (B) Miscellaneous Income

Banks generate various forms of non-interest income categorized as other income. Revenue derived from godown rents and the bank's own properties is specifically classified under miscellaneous income. This differentiates it from primary fee-based income like commissions or brokerage and from investment-related earnings. Such classifications provide a clear view of the

type of insurance cost. This payment protects depositors up to a certain limit and is correctly recorded under the insurance sub-category. It is distinct from other expenses like employee provisions, rent, or legal charges.

35. (A) P-3, Q-1, R-4, S-2

Operating expenses are categorized to provide clarity on administrative costs. Printing and stationery include the costs of books and forms used by the bank. Rent, taxes, and lighting cover municipal taxes and electricity charges. Depreciation reflects the value reduction of bank property and fittings. Law charges encompass all legal expenses. Matching these correctly ensures that the financial statements accurately represent operational outflows.

36. (D) Secured by Tangible Assets

Advances are classified based on the nature of the security provided by the borrower. A loan backed by factory premises and warehouse machinery is secured by physical, identifiable items. Such advances are categorized as secured by tangible assets. This classification distinguishes them from unsecured loans or those only backed by government or bank guarantees, reflecting the lower credit risk associated with physical collateral.

37. (A) P-2, Q-1, R-3, S-4

Net Interest Income is the difference between interest earned and interest paid. Net Interest Margin is the ratio of this income to average total assets, indicating overall efficiency. The Economic Equity Ratio measures shareholders' funds against total assets to assess sustenance capacity. Stage 2 profit involves a more comprehensive calculation including non-interest items and taxes. These parameters are essential for analyzing bank performance.

38. (C) Unsecured Advances

Loans that do not have any physical collateral, such as property or equipment, and are not covered by any external guarantees from the government or other banks, are classified as unsecured advances. This category represents a higher risk profile for the bank compared to secured lending. Proper identification of unsecured advances is crucial for accurate risk

assessment and calculating necessary capital reserves.

39. (B) Reserve position management — Both Asset side and Liability side Management

Specific balance sheet management functions are often divided between assets and liabilities. However, reserve position management is unique as it involves managing both the liquid assets held to meet requirements and the liabilities that determine those requirements. Other functions like loan and investment management are primarily asset-side, while capital and deposit management are liability-side. This dual nature ensures comprehensive regulatory compliance.

40. (A) Stage 2: Income-Expense Functions

Stage 2 of Asset Liability Management focuses on enhancing profitability through income and expense functions. This includes generating fee income and service charges, managing taxes, and ensuring capital adequacy. It also involves controlling non-interest operating expenses to improve the net margin. This stage moves beyond the basic management of balance sheet volumes to optimize the efficiency and profitability of the bank's operations.

41. (A) Profit on revaluation of investment — Interest Income

Profit or loss resulting from the revaluation of investments is not considered interest income. Instead, it is classified under the other income category in the profit and loss account. Interest income is strictly reserved for earnings like interest on advances, discount on bills, and income from investments. Non-interest-related gains or losses on asset values must be categorized separately to ensure transparency.

42. (B) The process of directing fund flows to generate stable earnings and build equity over time.

Asset-liability management is the strategic process of directing fund flows within a financial institution. Its primary aim is to generate stable earnings and progressively build equity while managing the inherent risks of banking. This involves coordinating the management of assets and liabilities as an integral system. It is not about eliminating all risks but rather taking measured risks to ensure sustainability.

- 26.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Banks maintain cash balances with the central bank to meet statutory requirements and ensure liquidity for emergency funding. Surplus cash held above the mandatory reserve levels remains part of the most liquid asset category. This classification allows banks to access these funds quickly if needed, supporting their overall liquidity management strategy while ensuring compliance with regulatory frameworks and operational safety.

- 27.** (A) To generate stable earnings and build equity while taking measured business risks.

The fundamental goal of asset-liability management is to ensure the long-term profitability and solvency of the financial institution. This involves directing fund flows to generate stable earnings and progressively build equity. While banks must accept certain business risks to earn returns, these risks must be measured and managed. This approach balances the need for yield with the requirement for stability.

- 28.** (C) A negative gap (liabilities > assets)

A gap analysis compares the maturity or repricing profiles of assets and liabilities over specific time horizons. When a bank has 60% of its liabilities maturing compared to only 15% of its assets within six months, it faces a significant imbalance. Since liabilities exceed assets in this period, the bank is in a negative gap position, which has implications for liquidity.

- 29.** (B) The control of interest margins and net income on an ongoing and systematic basis.

When viewing a financial institution as an integral system, the primary management objective is the systematic control of interest margins and net income. This involves coordinating various financial linkages between assets and liabilities rather than managing them in isolation. By focusing on these relationships, the bank can optimize its overall financial performance and respond effectively to changing market conditions and risks.

- 30.** (C) Refinancing Risk

Refinancing risk occurs when depositors exercise their embedded options to seek premature repayment of their funds. This forces the bank to find new sources of funding to replace the outgoing deposits and continue financing its existing assets. The cost of these new funds may be higher than the original deposits, potentially impacting the bank's net interest margin and overall profitability.

- 31.** (D) It serves as a cushion for depositors and creditors to fall back in case of losses

Capital represents the owners' stake in the bank and serves as a vital financial buffer. It provides a cushion to absorb potential losses, protecting the interests of depositors and creditors. By maintaining adequate capital, a bank ensures its long-term solvency and enhances public confidence. This internal strength is essential for sustaining operations during economic downturns or periods of unexpected financial stress.

- 32.** (D) It must replace the outgoing deposit with another to refinance assets at potential new costs. When term deposits are prematurely withdrawn, the bank must immediately secure alternative funding to maintain the assets previously supported by those deposits. This process of replacing outgoing liabilities is known as refinancing. The new funds may come at different market interest rates, which could increase the bank's interest expense and alter its established interest rate spreads, necessitating careful balance sheet management.

- 33.** (A) IV, II, III, I

The assets side of a bank's balance sheet, representing the application of funds, follows a specific sequential order. It begins with the most liquid assets: cash in hand and balances with the central bank. This is followed by balances with other banks and money at call. Next are investments and then advances. Finally, less liquid items like fixed assets are listed.

- 34.** (C) Insurance

Operating expenses include various costs necessary for daily banking activities. The annual premium paid by a bank to the Deposit Insurance and Credit Guarantee Corporation is a specific

ANSWERS

1. (B) Spread Management
Stage 2 of Asset Liability Management focuses on income and expense functions to enhance bank profitability. Core objectives under this stage include spread management, generating fee income, service charges, tax management, and capital adequacy. It also involves the rigorous control of non-interest operating expenses. This stage helps banks optimize their financial performance beyond basic balance sheet item management.
2. (C) Advances secured by tangible assets within India — Fixed Assets
Advances secured by tangible assets within India are classified under the assets section of a bank's balance sheet within the category of advances. They are not categorized as fixed assets, which typically include immovable properties and equipment used for operations. Classification depends on the nature of the security and the geographical location of the assets held.
3. (A) For a period between 2 days and 14 days
The money market is segmented based on the duration for which funds are transacted. Transactions occurring on an overnight basis are classified as call money. In contrast, funds lent or borrowed for a period ranging from two days up to fourteen days fall under notice money. Any duration exceeding fourteen days is generally classified as term money.
4. (A) I only
Letters of credit and guarantees represent potential obligations that depend on future events, placing them under contingent liabilities. Non-banking assets acquired to satisfy claims are not classified as fixed assets used for business operations. Instead, these are typically categorized under other assets. Such distinctions ensure that the balance sheet accurately reflects the bank's operational and potential financial standing.
5. (D) The ratio of the shareholders' funds to the total assets
The Economic Equity Ratio is a critical measure used in asset-liability management to assess a bank's long-term sustenance and resilience. It is defined as the ratio of shareholders' funds to total assets. This metric indicates the proportion of assets financed by the bank's own capital, reflecting its ability to absorb potential losses and maintain financial stability.
6. (C) Both I and II
Asset-liability management involves matching specific assets to support individual liabilities on a per-liability basis. This process helps in managing interest rate and liquidity risks effectively. Additionally, the Economic Equity Ratio serves as a vital indicator for assessing the bank's sustenance capacity. Together, these concepts allow financial institutions to maintain stability while optimizing their earnings and capital structure.
7. (C) Third Schedule
Commercial banks are legally required to prepare their financial statements according to specific statutory requirements. Section 29 of the Banking Regulation Act 1949 mandates that banks maintain a balance sheet and profit and loss account. The specific forms and structures for these documents are prescribed and set out within the Third Schedule of this primary banking legislation.
8. (A) I and II only
At the macro-level, asset-liability management provides a framework for formulating business policies and efficiently allocating capital. At the micro-level, it aims to achieve profitability through price matching and ensures liquidity through maturity matching. Grouping assets and liabilities randomly would fail to address liquidity needs, making structured maturity profiles essential for effective risk management and operational stability.

43. (A) I only

The call money market specifically handles funds transacted on an overnight basis. Surplus cash parked with the central bank above mandatory reserve requirements is not part of the 'Balances with Banks' category; rather, it remains under 'Cash in Hand and Balances with RBI'. Accurate classification of these funds is essential for monitoring the bank's liquidity position and its regulatory compliance.

44. (C) Net Interest Income divided by average total assets

The Net Interest Margin is a key performance indicator that measures the efficiency of a bank's interest-earning activities. It is mathematically defined as the ratio of net interest income to average total assets. This metric reflects the spread the bank earns on its assets and is used to compare the profitability and risk management effectiveness across different financial institutions and periods.

45. (A) I only

Profit or loss from investment revaluation is netted, with a positive result shown under other income. However, dividends from joint ventures abroad are generally included under income earned by way of dividends, not exchange transactions. Correct categorization of these diverse income sources is necessary to provide an accurate picture of the bank's financial performance and the origins of its non-interest revenue.

46. (C) Section 29

Section 29 of the Banking Regulation Act 1949 is the primary legal provision that mandates commercial banks in India to prepare their annual financial statements. This includes the balance sheet and the profit and loss account. These documents must be prepared in the specific forms prescribed in the Third Schedule of the Act, ensuring uniformity and transparency across the banking sector.

47. (A) I and II only

Contingent liabilities are potential obligations that depend on future events, such as outstanding forward exchange contracts and arrears of cumulative dividends. These do not represent immediate debts but must be disclosed. A credit

balance in inter-office adjustments is not a contingent liability; it is classified under other liabilities and provisions on the balance sheet. Proper disclosure of contingencies is vital for risk assessment.

48. (B) March 26, 1992

The standardized forms for the balance sheet and profit and loss account used by banks were specified in the Third Schedule of the Banking Regulation Act. The Government of India finalized these forms through notification S.O. 240 (E), which was published in the Gazette of India on March 26, 1992. This standardization allows for consistent financial reporting and easier regulatory oversight.

49. (B) I and III only

Financial deregulation has introduced volatility in interest and exchange rates, making asset-liability management more critical. Top management increasingly recognizes that the nature of banking risks has fundamentally changed. Contrary to the idea of having no impact, rapid innovations in financial products constantly alter a bank's risk profile, requiring more sophisticated management techniques to ensure the institution's stability and continued profitability.

50. (C) Depositors exercising their option to seek premature repayment of their deposit

Refinancing risk arises when a bank's funding source is withdrawn earlier than expected, such as when depositors seek premature repayment. The bank must then find replacement funds to support its existing assets. If market conditions have changed, these new funds might be more expensive, potentially narrowing the interest spread and impacting the bank's ability to maintain its projected earnings levels.

(D) I, II, and III

Stage 2 of asset-liability management encompasses a range of policies aimed at improving the bank's overall financial health. This includes generating fee-based income and service charges to diversify revenue. It also involves tax management to optimize after-tax profits and ensuring capital adequacy to support business growth and absorb risks. These policies

CHAPTER 27

Capital Adequacy - Basel Norms

Oct/Nov 2024

1. Identify the incorrect statement regarding overall Capital Adequacy and Basel Norms.
 - (A) The Basel-I accord provided global standards for minimum capital requirements for banks based on the value and nature of assets held
 - (B) The ratio is calculated as Regulatory capital divided by only the risk-weighted assets for credit risk
 - (C) A comprehensive version of the revised framework introducing capital allocation for operational risks was issued in June 2006 for banks
 - (D) Regulatory capital consists of Tier 1 and Tier 2 capital, as Tier 3 capital has been phased out under the current Basel III guidelines

May/June 2011

2. For what time horizon should the future financial projections typically be based when assessing Key Sensitivities and Future Scenarios in the Internal Capital Adequacy Assessment Process (ICAAP) document?
 - (A) One to two years
 - (B) Three to five years
 - (C) Ten to fifteen years
 - (D) Over twenty-five years

Oct/Nov 2015

3. How is a “consolidated bank” defined within the context of capital adequacy norms?
 - (A) A group of entities where a licensed bank is the controlling entity, including all group entities under its control except exempted ones
 - (B) A single banking entity operating globally without any subsidiaries, joint ventures, or offshore corporate branches
 - (C) A banking structure that exclusively includes financial services and insurance businesses under a shared holding company model
 - (D) An amalgamation of local area banks and regional rural banks functioning under a

single corporate regulatory framework

May/June 2023

4. Consider the following categories identified in the “Risks Analysed” section of the Internal Capital Adequacy Assessment Process (ICAAP) Document:
 - I. Credit risk
 - II. Liquidity risk
 - III. Pension obligation risk
 - IV. Interest rate risk in the banking book
 - V. Reputational riskWhich of the above categories are explicitly required to be identified?
 - (A) I, II, and IV only
 - (B) I, III, IV, and V only
 - (C) II, III, IV, and V only
 - (D) I, II, III, IV, and V

Oct/Nov 2010

5. Why does the Revised Basel Framework offer distinct options with increasing risk-sensitivity for computing capital requirements for credit and operational risks?
 - (A) To impose a rigid, one-size-fits-all administrative burden on banks regardless of their total asset size or risk profile
 - (B) To strictly separate the computation of market risk from operational risk without allowing any advanced internal modeling
 - (C) To ensure that all banks eventually default to the Basic Indicator Approach to achieve absolute global uniformity
 - (D) To allow banks to choose an approach commensurate with the stage of development of their operations

May/June 2007

6. Identify the incorrect statement regarding the technical aggregation process in the Internal Capital Adequacy Assessment Process (ICAAP) document.
 - (A) It may cover any allowance made for diversification, including assumed

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bank's balance sheet. Therefore, it is categorized as an asset-side management function. Liability-side management focuses on sources of funds, such as managing deposits, capital, and long-term notes or debentures. Correctly identifying these functions is essential for implementing a balanced and effective ALM strategy.

61. (D) I, II, III, IV, and V

Asset-side management encompasses a wide range of functions related to the allocation of a bank's funds. This includes maintaining the reserve position, managing liquidity, and overseeing the investment and loan portfolios. Additionally, the management of physical fixed assets falls under this category. These functions collectively ensure that the bank's assets generate sufficient returns while remaining within the desired risk and liquidity parameters.

62. (C) Discount/interest on all borrowings/refinance from RBI

Operating expenses cover the administrative and functional costs of running a bank, such as postage, depreciation, and auditors' fees. However, interest or discount paid on borrowings and refinance from the central bank represents the cost of funds. This cost is classified separately under interest expended in the profit and loss account, as it is a direct financial cost rather than an operational one.

63. (D) Assertion (A) is false, but Reason (R) is true.
When borrowers exercise the option to prepay their loans, the bank receives its capital back earlier than scheduled. This creates reinvestment risk, not refinancing risk, as the bank must find new opportunities to deploy those funds. The reason correctly identifies that the challenge lies in redeploying funds at potentially different rates. Refinancing risk, conversely, is associated with the withdrawal of deposits.

64. (D) Dividend and interest income earned on the investment portfolio of the bank.

Other income in a bank's profit and loss account includes miscellaneous items like foreign exchange profits, locker rents, and gains from the sale of land or buildings. However, interest and dividends earned directly from the bank's investment portfolio are classified as interest income. This core revenue stream is kept separate

from ancillary income sources to provide a clearer view of financial performance.

65. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

In banking, there is a fundamental correlation between risk and return. Maintaining larger spreads often requires taking on higher risks, such as lending to borrowers with lower credit ratings or engaging in longer-term maturity transformation. Therefore, while a higher spread can lead to greater profitability, it also serves as an indicator of the increased risk exposure the institution has accepted.

66. (C) Liquidity management

The income-expense stage of asset-liability management focuses on profitability through spread management, fee income generation, and cost control. Liquidity management, however, is a fundamental balance sheet function that falls under the first stage. While essential for overall stability, liquidity management is concerned with the volume and timing of cash flows rather than the direct optimization of income and expenditure items.

67. (A) A liquidity crisis that renders the bank temporarily or technically insolvent.

Even if a bank has sufficient total assets, a significant maturity mismatch where liabilities mature much faster than assets can lead to a liquidity crisis. If the bank cannot meet its immediate obligations to depositors, it may face technical insolvency. This scenario highlights the importance of maturity matching in asset-liability management to ensure that cash inflows are sufficient to cover outflows.

68. (D) Managing asset and liability composition in response to corporate goals and conditions.

Balance sheet restructuring is a dynamic management strategy. It involves intentionally altering the composition of a bank's assets and liabilities to align with changing corporate goals or market conditions. This might include shifting the mix of deposits or changing the focus of the loan portfolio. The objective is to optimize the bank's risk-return profile and ensure its continued stability and profitability.

work together to enhance the bank's profitability and capital base.

52. (D) As the 'Spread' on earning assets

Conceptually, the Net Interest Margin is often viewed as the 'spread' earned on a bank's interest-bearing assets. It represents the difference between the interest income generated and the interest expense incurred, expressed as a percentage of assets. This spread is a primary indicator of how well the bank is performing its core function of financial intermediation and managing its interest rate risk.

53. (A) I, II, and IV

Other income includes non-interest revenue streams like locker rents, profits from foreign exchange dealings, and recoveries from godown rents. These are distinct from the bank's core interest earnings. However, interest earned on balances held with the central bank is specifically classified as interest income rather than other income. Distinguishing these sources helps stakeholders understand the composition of the bank's total revenue.

54. (C) Claims against the bank not acknowledged as debts

Contingent liabilities include items that represent potential financial obligations, such as claims against the bank that have not been legally acknowledged as debts. These are items that may become actual liabilities depending on the outcome of future events. Items like tax payments or share premiums are actual balance sheet items, while current account balances are assets, not potential future obligations.

55. (B) I, III, and IV

Asset-liability management is a strategic and dynamic process focused on altering the portfolio to maximize profit. It requires forecasting and proactive decision-making to adapt to market changes. Importantly, its goal is not to completely avoid all risks—as risk-taking is inherent to banking—but rather to manage those risks effectively to ensure stability and sustain the institution's long-term profitability.

56. (A) Deploying liabilities at rates higher than their costs to maintain interest spreads

At the micro-level of asset-liability management, the objective of price matching is to ensure that funds are deployed at interest rates higher than their acquisition costs. This practice maintains a healthy interest spread, which is the primary source of a bank's profitability. By carefully matching the pricing of assets and liabilities, the bank can protect its net interest margin from volatility.

57. (A) I, II, III, and IV

Operating expenses include a variety of administrative costs such as employee welfare allowances, stationery costs not related to publicity, and director fees. Postage and courier charges are also standard operating costs. However, a diminution in the value of investments is an impairment charge, which is typically classified under provisions and contingencies rather than general operating expenses in the bank's financial statements.

58. (B) Capital represents the owners' stake and is considered a short-term source of funds

Capital is the fundamental stake held by the bank's owners and is considered a long-term, permanent source of funds, not a short-term one. It serves as a permanent cushion to absorb losses and support long-term growth. Deposits and borrowings are different classes of liabilities, with deposits often being classified based on their maturity or withdrawal terms like demand or savings.

59. (B) I, III, IV, and V

This category includes payables like mail transfers, interest accrued but not yet due, and various tax-related provisions. It serves as a catch-all for liabilities that do not fit into deposits or borrowings. Notably, a debit balance in inter-office adjustments would be classified under other assets, while only a credit balance belongs here. This distinction ensures that the balance sheet remains correctly balanced.

60. (C) Liability side management includes Fixed-Assets Management

Fixed-assets management involves the acquisition and maintenance of physical property and equipment, which are assets on the

78. (A) P-2, Q-1, R-4, S-3

Refinancing risk arises when depositors seek premature repayment, while reinvestment risk occurs when borrowers prepay loans. A positive gap allows an institution to benefit from rising interest rates because more assets reprice than liabilities. Conversely, a negative gap positions the bank to benefit from declining rates. Understanding these relationships is fundamental to managing interest rate sensitivity and protecting the bank's net interest margin.

79. (D) Stage 1: Specific Balance Sheet Management Functions

The management of reserve positions and overall liquidity on the asset side represents the foundational stage of balance sheet management. Known as Stage 1, these functions focus on specific volumes and the timing of fund flows to ensure regulatory compliance and operational readiness. This stage precedes more advanced profitability-focused functions like spread management or strategic profit planning, which are addressed in later stages.

80. (D) Unadjusted debit balances representing deductions from liabilities — Other Assets

Balance sheet items must be categorized accurately to reflect the true financial position. Unadjusted debit balances that represent deductions from liabilities are classified under other assets. Other items like overdue deposits are liabilities, not contingencies, and tax provisions belong under other liabilities, not reserves. Correct classification ensures that the bank's resources and obligations are clearly distinguished for stakeholders and regulators according to statutory requirements.

and mitigation of risks.

2. Independent monitoring and testing of risk management processes to avoid conflicts of interest.
3. Senior management should take an integrated perspective to identify and react to emerging risks.
4. Setting the tolerance level for risk and ensuring a strategic plan is in place.

- (A) P-1, Q-2, R-3, S-4
(B) P-3, Q-4, R-1, S-2
(C) P-4, Q-3, R-2, S-1
(D) P-2, Q-1, R-4, S-3

May/June 2024

24. Which of the following matching of Pillar 3 Disclosure Tables to their core subject is INCORRECT?
- (A) Table DF-8 — Interest Rate Risk in the Banking Book (IRRBB)
(B) Table DF-5 — Credit Risk Mitigation
(C) Table DF-7 — Market risk in trading Book
(D) Table DF-10 — General Disclosure for exposures related to counter party credit risk

Oct/Nov 2013

25. Gamma Bank's Board of Directors has recently delegated the ultimate responsibility for designing and implementing the Internal Capital Adequacy Assessment Process (ICAAP) entirely to the Chief Risk Officer (CRO), stating that the Board will no longer review or approve the ICAAP document. Does this action align with the guidelines for the Supervisory Review Process (SRP)?
- (A) No, because the ultimate responsibility for designing and implementing the ICAAP lies with the bank's board of directors.
(B) Yes, because the CRO possesses the technical expertise required for ICAAP implementation.
(C) Yes, provided the CRO reports the final capital numbers directly to the regulator.
(D) No, because the ICAAP must be designed collaboratively by external auditors and the bank's shareholders.

May/June 2015

26. The qualitative disclosures for portfolios under the standardised approach (Table DF-4) require all of the following EXCEPT:

- (A) Names of all external credit rating agencies used for risk weighting
(B) The proprietary algorithms utilized by the rating agencies
(C) Reasons for any changes in the specific credit rating agencies used
(D) Specific types of exposure for which each external agency is used

Oct/Nov 2025

27. Which of the following statements correctly identifies a requirement for a bank's Management Information Systems (MIS) under the Internal Capital Adequacy Assessment Process (ICAAP) framework?
- (A) MIS must provide regular, accurate, and timely information on the bank's aggregate risk profile for proactive management
(B) MIS should intentionally obscure the main assumptions used for risk aggregation to prevent potential proprietary information leaks
(C) MIS is only required to report on credit risk, leaving market and operational risks to be handled by external rating agencies
(D) MIS should report all internal limit breaches only on an annual basis to the board of directors to simplify oversight

May/June 2018

28. According to regulatory circulars, what triggers the requirement for a bank to disclose the market value of investments held in the Held to Maturity (HTM) category and indicate the excess of book value over market value?
- (A) If the bank decides to issue new Tier-II capital bonds to meet the increasing demand for regulatory capital reserves
(B) If the bank's capital to risk-weighted assets ratio (CRAR) falls below the mandatory 9% threshold prescribed for Indian banks
(C) If sales and transfers from HTM exceed 5% of its book value at the beginning of the year
(D) If the gross non-performing assets (NPAs) exceed 10% of total advances across all domestic and international portfolios

Oct/Nov 2017

29. For a bank that defines its activities and risk management practices as moderately complex, carrying out its Internal Capital Adequacy

correlations between risks.

- (B) It requires justification for any credit taken for diversification benefits between legal entities.
- (C) It prohibits the assessment of the inherent uncertainty in any modelling approach when arriving at the overall capital assessment.
- (D) It is helpful to work out revised ICAAP figures assuming all risks are independent, i.e., full diversification.

Oct/Nov 2006

7. Consider the following statements regarding the Internal Capital Adequacy Assessment Process (ICAAP):
- I. The ICAAP is designed to address risks that are not fully captured or not taken into account at all by the minimum capital ratio prescribed under Pillar 1.
 - II. The ICAAP document must be prepared exclusively on a consolidated basis, exempting the need for preparation at the solo basis for each banking entity.
- Which of the above statement(s) is/are correct?
- (A) Only statement I is correct
 - (B) Only statement II is correct
 - (C) Both statements I and II are correct
 - (D) Neither statement I nor II is correct

May/June 2020

8. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.
- Assertion (A): The calculation of risk-adjusted performance measure for employees and its link with compensation should clearly be disclosed in the Internal Capital Adequacy Assessment Process (ICAAP) Document.
- Reason (R): Sound compensation practices should be linked to long-term capital preservation and the financial strength of the firm.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2014

9. Arrange the following evolutionary milestones of the capital adequacy frameworks in the correct chronological order based on their introduction and revisions.
- I. Comprehensive version of the revised framework issued
 - II. Basel-I accord making capital requirement based on the value and nature of assets
 - III. A revision exercise began to address limitations in the accord
 - IV. Revised framework finalised promoting the adoption of stronger risk management practices
- (A) II, III, IV, I
 - (B) II, III, I, IV
 - (C) III, II, IV, I
 - (D) II, IV, III, I

May/June 2012

10. When outlining the “Management Actions” in deriving the Internal Capital Adequacy Assessment Process (ICAAP), the section should elaborate on all of the following EXCEPT:
- (A) The quantitative impact of management actions on the overall capital ratio
 - (B) Guarantees that management actions will eliminate the need for Tier-I capital
 - (C) Sensitivity testing of key management actions under various stressed scenarios
 - (D) Revised ICAAP figures with management actions excluded to show gross risk

Oct/Nov 2018

11. Identify the incorrect statement regarding the Three Pillars of Basel-III.
- (A) The accord restricts home country supervisors from leading enhanced cooperation with host country supervisors.
 - (B) The revised framework introduces capital allocation for operational risk for the first time.
 - (C) Basel-III aligns regulatory capital with the banks' risk profiles and provides greater use of Banks' internal systems.
 - (D) Basel-III provides incentives for banks to invest and increase the sophistication of their internal risk management capabilities.

May/June 2016

12. Consider the following information demonstrating how capital management is embedded within a bank in the “Use of the ICAAP within the Bank” section:

- I. Use of the Internal Capital Adequacy Assessment Process (ICAAP) in setting pricing and charges.
- II. The level and nature of future business as an indicator of capital management.
- III. The deliberate separation of the ICAAP document from the bank’s actual operating philosophy on capital management.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2023

13. Consider the following statements regarding the calculation of total risk weighted assets:

- I. The area of operational risk is brought under the ambit of risk-weighted assets for the first time.
- II. Total risk weighted assets include the capital requirement for market risk multiplied by 12.5.
- III. Total risk weighted assets exclude the capital requirement for operational risk, treating it solely as an absolute capital charge.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2019

14. How is “Proprietary Information” defined in the context of Pillar 3 disclosures?

- (A) Information that is legally mandated to be shared with all competing banks to ensure complete and total market transparency
- (B) Information regarding the specific identities, backgrounds, and professional certifications of the board of directors and senior management
- (C) Information on products or systems that, if shared, would render a bank’s investment less valuable and undermine its position
- (D) Information that exclusively details the uniform salary structure and benefit

packages of the bank’s various clerical and support staff

Oct/Nov 2007

15. Alpha Bank’s regulatory capital minimum requirement under Pillar 1 is sufficient for its credit, market, and operational risks. However, the bank frequently faces delayed settlements from counterparties and significant reputational challenges due to recent service outages. How should Alpha Bank address these specific issues in relation to its capital adequacy?

- (A) The bank should decrease its Tier-I capital reserves since these specific risks tend to cancel out traditional credit risk buffers
- (B) The bank must transfer these risks exclusively to Pillar 3 for market disclosure without altering its current internal capital levels
- (C) The bank should replace its current operational risk capital charge with a dedicated reputational risk capital charge under Pillar 1
- (D) The bank should hold additional capital under Pillar 2, as these risks are not fully captured in the regulatory CRAR

May/June 2025

16. Match the items in List I with the corresponding items in List II.

List I: (Table Number)

- P. Table DF-2
- Q. Table DF-3
- R. Table DF-6
- S. Table DF-9

List II: (Disclosure Title)

1. Securitisation Exposures: Disclosure for Standardised Approach
 2. Credit Risk: General Disclosures for all Banks
 3. Interest Rate Risk in the Banking Book (IRRBB)
 4. Capital Adequacy
- (A) P-2, Q-4, R-3, S-1
 - (B) P-3, Q-1, R-4, S-2
 - (C) P-1, Q-2, R-3, S-4
 - (D) P-4, Q-2, R-1, S-3

Oct/Nov 2005

17. Which of the following provides the most accurate definition of “Model risk” as discussed in the Supervisory Review Process?

NODIA

- (A) The risk that a bank's internal MIS will fail to report aggregate risks to the board of directors.
- (B) The risk of under-estimation of credit risk under the Internal Rating Based (IRB) approaches.
- (C) The risk of weakness in the credit-risk mitigants under the Standardised approach.
- (D) The risk associated with the residual effects of securitisation in the trading book.

May/June 2005

18. A commercial bank omits certain risk exposure data from its Pillar 3 disclosures, arguing that the omitted data would not change or influence the assessment or decision of a user relying on that information. What concept is the bank applying to justify this omission?
- (A) Proprietary Information
 - (B) General Disclosure Principle
 - (C) Materiality
 - (D) Confidentiality

Oct/Nov 2009

19. Which of the following pairs incorrectly maps a risk to its categorization?
- (A) Settlement risk — part of operational risk
 - (B) Credit concentration risk — categorised as a subset of the broader credit risk framework
 - (C) Liquidity risk — categorised as a Pillar 2 risk requiring separate assessment
 - (D) Strategic risk — categorised as a Pillar 2 risk requiring separate assessment

May/June 2014

20. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.
- Assertion (A): Market discipline contributes to a safe and sound banking environment by exercising a salutary effect on the bank.
- Reason (R): Market discipline empowers market participants with full and critical information, acting as a disciplinary agent.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.

- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2021

21. According to the principles of the Supervisory Review Process, why is the integration of the Internal Capital Adequacy Assessment Process (ICAAP) into the management and decision-making culture of a bank emphasized?
- (A) To replace the role of external auditors in financial reporting and verification of capital adequacy ratios
 - (B) To guarantee that all subsidiary branches maintain identical strategic plans regardless of specific local market conditions
 - (C) To shift the ultimate responsibility for risk management from the board of directors to the central regulatory authority
 - (D) To ensure it plays a role in credit decisions, product pricing, and general business expansion plans

May/June 2017

22. Under Table DF-1 (Scope of Application), why must a bank explain the reasons for differences in the method of consolidation between the accounting scope and the regulatory scope?
- (A) Because regulatory consolidation strictly prohibits the inclusion of any international branches or offshore financial subsidiaries
 - (B) Because the accounting scope only considers non-performing assets, while the regulatory scope only considers performing assets
 - (C) Because accounting consolidation might include entities like insurance subsidiaries treated differently under regulatory frameworks
 - (D) Because the bank must prove that it has no subsidiaries in order to comply with the latest Basel III global standards

Oct/Nov 2022

23. Match the items in List I with the corresponding items in List II.
- List I: (Structural Aspect of ICAAP)
- P. General firm-wide risk management principles
 - Q. Board and Senior Management Oversight
 - R. Policies, procedures, limits and controls
 - S. Internal controls
- List II: (Feature or Requirement)
- 1. Should provide for adequate and timely identification, measurement, monitoring,

- 69.** (D) The institution is in a position to benefit from the declining interest rates.

An institution with a negative gap has more liabilities than assets repricing in a given period. If market interest rates decline, the cost of these liabilities will fall faster than the yield on its assets. This leads to an expansion of the interest margin. Consequently, Zenith Bank's negative gap position strategically positions it to benefit from the projected decline in interest rates.

- 70.** (C) By grouping assets and liabilities based on maturing profiles to identify financing needs.

At the micro-level, liquidity is ensured by analyzing the maturity profiles of various assets and liabilities. By grouping these items into time buckets, the bank can identify potential periods of cash deficits or surpluses. This detailed visibility allows management to plan for financing needs and maintain sufficient liquid resources to meet all obligations as they fall due, preventing unexpected liquidity shortages.

- 71.** (B) Reinvestment Risk

Reinvestment risk materializes when borrowers prepay their loans, especially when market interest rates have dropped. The bank is then forced to reinvest the returned principal at current, lower market rates, which reduces its future interest income. This risk directly affects the bank's net interest margin and highlights the challenges of managing portfolios containing loans with prepayment options during periods of falling rates.

- 72.** (B) I, II, III, IV

The ALM process begins with a review of interest rate structures and product pricing. Next, loan and investment portfolios are examined for liquidity and foreign exchange risks. This is followed by an assessment of credit and contingency risks arising from rate fluctuations. Finally, actual performance is reviewed against projections to analyze any effects on spreads, completing a systematic cycle of risk management.

- 73.** (A) Commission, Exchange and Brokerage

Revenue generated from services such as locker rentals is classified under the head of miscellaneous income in the profit and loss account. It is a standard fee-based service provided by banks and is categorized under

this heading. Correct classification ensures that fee-based revenue is clearly distinguished from interest earnings and primary fee-based income like commissions or brokerage.

- 74.** (A) P-3, Q-4, R-1, S-2

Sources of funds represent the liabilities side of a bank's balance sheet. Capital is the owners' stake that acts as a buffer against losses. Reserves and surplus include share premiums and retained profits. Deposits consist of customer funds in current and savings accounts. Borrowings include refinance from external entities like NABARD. Correctly matching these ensures a clear understanding of the bank's funding base.

- 75.** (A) Provisions and Contingencies

When the value of a bank's investment portfolio decreases, the resulting diminution is recognized as a cost. In bank accounting, such valuation adjustments and impairments are categorized under provisions and contingencies. This is distinct from regular operating expenses like rent or salaries and from interest costs. Recording it here ensures that the bank's net profit accurately reflects the impact of market-driven asset value changes.

- 76.** (A) P-2, Q-1, R-4, S-3

Other assets include diverse items like accrued interest not yet collected and non-banking assets acquired from defaulting borrowers. Advance tax payments that haven't been offset against provisions are also listed here. The 'others' sub-category captures miscellaneous items like clearing balances and unadjusted debit amounts. Matching these components correctly is essential for a detailed and accurate representation of the bank's total asset position.

- 77.** (B) Covered by Bank/Government Guarantees

Advances are classified based on the security provided. When a loan is not backed by physical tangible assets but instead has a guarantee from an entity like the Export Credit Guarantee Corporation, it is classified as covered by bank/government guarantees. This category acknowledges that while the bank doesn't hold physical collateral, the credit risk is mitigated by a reliable external third-party guarantee.

Assessment Process (ICAAP) could involve all of the following EXCEPT:

- (A) Preparing a comprehensive list of the major risks to which the business is exposed.
- (B) Estimating the range and distribution of possible losses using shock stress tests.
- (C) Projecting business activities forward in detail for one year and in less detail for the next 3-5 years.
- (D) Assuming that business develops exactly as expected without considering any adverse economic scenarios.

May/June 2006

30. In order to promote transparency, a bank finds that the additional gross NPAs identified by the regulator exceed 15% of the published incremental gross NPAs for the reference period. What action must the bank take according to standard transparency requirements?
- (A) The bank must immediately suspend all lending operations and liquidate its high-risk asset portfolios.
 - (B) The bank should make suitable disclosures regarding the material divergences in its published financial statements.
 - (C) The bank should report the divergence only to the central bank while keeping the public financial statements unchanged.
 - (D) The bank is allowed to keep the divergence confidential to prevent market panic and maintain depositor confidence.

Oct/Nov 2008

31. Consider the following statements regarding the regular independent review and validation of the Internal Capital Adequacy Assessment Process (ICAAP):
- I. The ICAAP should be subject to regular and independent review through an internal or external audit process.
 - II. The periodic reviews should ensure the timely identification of any concentration risk.
- Which of the above statement(s) is/are correct?
- (A) Only statement I is correct
 - (B) Only statement II is correct
 - (C) Both statements I and II are correct
 - (D) Neither statement I nor II is correct

May/June 2010

32. Consider the following statements regarding the requirement for banks to make the full terms and conditions of instruments included in regulatory capital available on their websites:
- I. Allow supervisors to investigate specific features of individual capital instruments.
 - II. Allow market participants to investigate specific features of individual capital instruments.
 - III. Keep the terms and conditions up-to-date in the prescribed form.
 - IV. Restrict the information exclusively to the bank's internal auditors.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, and IV only

Oct/Nov 2016

33. Bank Sigma incurred material risk exposures related to reputation risk and strategic risk. The risk management team spent six months attempting to quantify these risks into absolute financial metrics but failed to produce reliable data. According to the Internal Capital Adequacy Assessment Process (ICAAP) guidelines, how should Bank Sigma address these specific risks?
- (A) Exclude them entirely from the ICAAP document since they cannot be reliably quantified.
 - (B) Focus more on qualitative assessment, risk management, and mitigation rather than strict quantification.
 - (C) Assign them an arbitrary capital charge of 12.5% to align with operational risk parameters.
 - (D) Request an exemption from Pillar 2 requirements for these particular risks.

May/June 2009

34. What is the underlying philosophy behind the quote: "A well-run bank needs no capital. No amount of capital will rescue a badly run bank"?
- (A) It emphasizes that banks should entirely eliminate their capital reserves to maximize shareholder dividends and stock value
 - (B) It suggests that the Basel III framework is obsolete and should be replaced by completely unregulated banking practices
 - (C) It highlights that while capital is necessary,

NODIA

geographic region as the parent holding company

May/June 2019

56. Holding additional capital beyond the regulatory minimum level under Pillar 1 might be necessary on account of various risks not fully captured. All of the following are examples of such risks EXCEPT:
- (A) Foreign exchange risk under the Standardised duration approach
 - (B) Credit concentration risk arising from large exposures to a single counterparty or group
 - (C) Liquidity risk associated with the inability to meet obligations without incurring unacceptable losses
 - (D) Interest rate risk in the banking book resulting from mismatches in the maturity of assets and liabilities

Oct/Nov 2007

57. Consider the following statements regarding the validation of Pillar 3 disclosures:
- I. The disclosures should be subjected to adequate validation, and material published with annual financial statements must be consistent with the audited statements.
 - II. Presently, Pillar 3 disclosures are mandatorily required to be audited by an external auditor in all cases without exception.
- Which of the above statement(s) is/are correct?
- (A) Only statement I is correct
 - (B) Only statement II is correct
 - (C) Both statements I and II are correct
 - (D) Neither statement I nor II is correct

May/June 2025

58. Which of the following pairs correctly matches the specific risk to its broader risk category equivalent as per the Internal Capital Adequacy Assessment Process (ICAAP) framework?
- (A) Interest rate risk in the banking book — Part of operational risk
 - (B) Reputational risk — Categorised as a Pillar 2 risk
 - (C) Settlement risk — Part of market risk
 - (D) Strategic risk — Equivalent to credit risk

Oct/Nov 2005

59. Consider the following quantitative disclosures required under Table DF-3 (Credit Risk: General Disclosures for all Banks):
- I. Total gross credit risk exposures, Fund based and Non-fund based separately.
 - II. Geographic distribution of exposures, Overseas and Domestic.
 - III. Residual contractual maturity breakdown of assets.
 - IV. Amount of NPAs (Gross) categorized into Substandard, Doubtful 1, Doubtful 2, Doubtful 3, and Loss.
 - V. Names of all individual customers who have defaulted on their loans.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V only
 - (B) I, II, III, and IV only
 - (C) II, III, IV, and V only
 - (D) I, III, IV, and V only

May/June 2005

60. The Basel Committee has laid down four key principles in regard to the Supervisory Review Process (SRP) under Pillar 2. Consider the following statements:
- I. Banks should have a process for assessing their overall capital adequacy in relation to their risk profile.
 - II. Supervisors should evaluate banks' internal capital adequacy assessments and take appropriate supervisory action if not satisfied.
 - III. Supervisors should expect banks to operate precisely at the minimum regulatory capital ratios, preventing any excess capital holding.
 - IV. Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, II, and IV only
 - (C) II, III, and IV only
 - (D) I, III, and IV only

Oct/Nov 2009

61. What is the primary rationale for requiring banks to maintain a common template for reporting details of their regulatory capital?
- (A) To eliminate the need for banks to maintain their own independent websites.
 - (B) To meet the Basel III requirement to disclose

authority

- (B) No, the document must state if capital represents minimum regulatory needs or capital required for actual business plans
- (C) Yes, because expansion plans are handled exclusively under Pillar 3 market disclosures to inform potential investors and stakeholders
- (D) No, because expansion plans must only be documented in the bank's annual audited financial statements, not the internal ICAAP.

May/June 2008

- 40.** Consider the following items explained in the Internal Capital Adequacy Assessment Process (ICAAP) Document's "Summary of Current and Projected Financial and Capital Positions" section:
- I. The present financial position of the bank.
 - II. Expected changes to the current business profile.
 - III. The environment in which it expects to operate.
 - IV. Its projected business plans by appropriate lines of business.
 - V. Future planned sources of capital.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV only
 - (B) II, III, IV, and V only
 - (C) I, III, IV, and V only
 - (D) I, II, III, IV, and V

Oct/Nov 2011

- 41.** Consider the following statements regarding the "Firm-wide Risk Oversight and Specific Aspects of Risk Management" section and the assessment of securitisation:
- I. Analysis of the credit quality and risk characteristics of the underlying exposures.
 - II. Explanation of the maturity of the exposures underlying securitisation transactions relative to issued liabilities.
 - III. Elimination of any requirement to monitor changes in market risk of securitisation exposures.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

May/June 2013

- 42.** What is the primary objective of Pillar 2, also known as the Supervisory Review Process (SRP)?
- (A) To establish global standards for minimum capital requirements for internationally active banks
 - (B) To ensure that banks have adequate capital to support all risks and encourage better risk management techniques
 - (C) To provide disclosure requirements that allow market participants to assess key information about banks
 - (D) To mandate specific internal rating-based approaches for credit risk calculation across all commercial banks

Oct/Nov 2024

- 43.** Arrange the following sections of the Internal Capital Adequacy Assessment Process (ICAAP) Document in their standard illustrative order.
- I. Summary of Current and Projected Financial and Capital Positions
 - II. Background
 - III. Executive Summary
 - IV. Capital Adequacy
- (A) III, II, I, IV
 - (B) II, III, I, IV
 - (C) III, I, II, IV
 - (D) I, II, III, IV

May/June 2011

- 44.** Capital adequacy norms are applicable uniformly to all Commercial Banks, both at the solo level and the consolidated level, EXCEPT:
- (A) Public Sector Banks, Private Sector Banks, and Foreign Banks
 - (B) Scheduled Commercial Banks and Non-Scheduled Commercial Banks
 - (C) Co-operative Banks, Local Area Banks, and Regional Rural Banks
 - (D) Controlling entities and their respective non-exempted financial subsidiaries

Oct/Nov 2015

- 45.** What is the most appropriate way a bank should evaluate the overall reasonableness of its detailed quantification approaches for capital adequacy?
- (A) By replacing all internal models with the Basic Indicator Approach immediately to ensure absolute uniformity across all

NODIA

departments

- (B) By comparing them with capital planning analysis and senior management's view on the overall level of appropriate capital
- (C) By assuming all risks are 100% correlated and demanding capital equal to total assets regardless of the specific risk profiles
- (D) By strictly relying on external audit opinions and international consulting reports without any direct input from senior management

May/June 2023

46. Match the items in List I with the corresponding items in List II.

List I: (Risk Approach)

- P. Standardised Approach
- Q. Basic Indicator Approach
- R. Advanced Measurement Approach
- S. Internal models such as VAR

List II: (Categorization)

- 1. Credit Risk Option
- 2. Operational Risk Option (Basic)
- 3. Operational Risk Option (Advanced)
- 4. Market Risk Option (Advanced)

- (A) P-2, Q-3, R-1, S-4
- (B) P-3, Q-1, R-4, S-2
- (C) P-1, Q-2, R-3, S-4
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2010

47. Theta Bank operates a conglomerate structure with several overseas banking subsidiaries. In its Internal Capital Adequacy Assessment Process (ICAAP) document under the "Capital Transferability" section, the bank fails to mention that the host-country regulator of one of its subsidiaries strictly limits the transfer of capital out of the subsidiary. What is the implication of this omission?

- (A) The bank is fully compliant, as overseas regulations do not impact consolidated ICAAP reporting.
- (B) The bank is compliant, provided the subsidiary pays standard dividends.
- (C) The bank must immediately liquidate the overseas subsidiary to maintain capital transferability.
- (D) The bank is non-compliant, as details of any restrictions on the management's ability to transfer capital into or out of the banking business must be furnished.

May/June 2007

48. Which of the following statements correctly describes the capital ratio requirements under Pillar I?

- (A) Tier-III capital continues to be an integral part of eligible regulatory capital under the Basel III guidelines.
- (B) Any capital requirement arising in respect of operational risk needs to be met exclusively by Tier-II capital.
- (C) Tier-II capital is restricted to a maximum of 50% of Tier-I capital as per the revised framework.
- (D) The total capital ratio must not be lower than 8% globally and is prescribed at 9% in India.

Oct/Nov 2006

49. Consider the following assessments regarding how an economic downturn scenario would affect a bank in the Internal Capital Adequacy Assessment Process (ICAAP):

- I. The bank's capital funds.
- II. The bank's future earnings.
- III. The bank's capital to risk-weighted assets ratio (CRAR) taking into account future changes in its projected balance sheet.
- IV. The bank's minimum regulatory requirement to completely cease lending operations.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, and IV only

May/June 2020

50. Read the following scenario and answer the question that follows:

A prominent commercial bank has established a robust Internal Capital Adequacy Assessment Process (ICAAP). The bank's operations include a traditional banking division and a wholly-owned subsidiary exclusively engaged in the insurance business. When determining the scope of application for its consolidated capital adequacy ratio, how should the bank treat the insurance subsidiary?

- (A) The insurance subsidiary must be fully consolidated into the capital adequacy calculation alongside all financial service entities.

- (B) The insurance subsidiary's assets must be merged but its operational risks handled separately under Pillar 2.
- (C) The insurance subsidiary should be excluded from the consolidated bank group for capital adequacy purposes.
- (D) The insurance subsidiary must be included only if its risk profile is identical to the main banking division.

Oct/Nov 2014

51. To validate its Internal Capital Adequacy Assessment Process (ICAAP) models, Epsilon Bank hires an external consulting firm to generate economic scenarios and conduct independent testing. According to the guidelines on the "Testing and Adoption of the ICAAP", how should the bank treat this external input?
- (A) Details of the reliance placed on any external service providers or consultants in the testing process should be detailed in the document.
 - (B) The bank must keep the reliance on external providers strictly confidential and exclude it from the ICAAP document.
 - (C) The bank must adopt the external consultant's findings as the sole determining factor for its risk appetite.
 - (D) The external consulting firm must submit their findings directly to the regulatory authority, bypassing the bank's Board of Directors.

May/June 2012

52. Which of the following constitutes supplementary capital (Tier-II capital)?
- (A) Paid up capital, free reserves, unallocated surpluses, and other statutory reserves maintained for regulatory compliance
 - (B) Revaluation reserves integrated exclusively into Tier-III capital structures to offset long-term market fluctuations
 - (C) Capital requirement for market risk multiplied by a factor of 12.5 to determine the risk-weighted asset equivalent
 - (D) Subordinated debt, loan loss reserves, and limited life preference shares with more than five years' maturity

Oct/Nov 2018

53. Which of the following guiding principles on Pillar 3 disclosures is correctly paired with its principle number?
- (A) Principle 1: Disclosures should be comprehensive.
 - (B) Principle 3: Disclosures should be meaningful to users.
 - (C) Principle 4: Disclosures should be comparable across banks.
 - (D) Principle 5: Disclosures should be clear.

May/June 2016

54. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.
- Assertion (A): The Basel III guidelines have phased out the provision of Tier-III capital.
- Reason (R): Tier-III capital was originally provided under Basel II guidelines primarily to take care of the market risk of the banks.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2023

55. Read the following scenario and answer the question that follows:
- Gamma Group is a top consolidated banking entity. It has several subsidiary banks. According to the scope and frequency of Pillar 3 disclosures, how should the disclosures generally be handled within the group?*
- (A) Each individual bank within the group must separately publish complete Pillar 3 disclosures regardless of the parent bank's actions or size
 - (B) Pillar 3 applies at the top consolidated level; disclosures for individual banks within the group are generally not required
 - (C) The parent bank is explicitly forbidden from disclosing capital ratios of any of its significant bank subsidiaries in any public report
 - (D) Disclosures must only be made if the subsidiary banks are located in the same

- (C) I and III only
(D) I, II, and III

Oct/Nov 2013

67. Nova Bank uses both on-balance sheet netting and eligible financial collateral to mitigate credit risk. When preparing Table DF-5 (Credit Risk Mitigation), how should the bank report its quantitative disclosures for separately disclosed credit risk portfolios?
- (A) By reporting total exposure after applicable netting and covered by eligible financial collateral after applying haircuts
(B) By reporting only the initial gross exposure before the application of any haircuts, netting, or credit risk mitigants
(C) By hiding the effect of the credit derivatives used, as they are considered highly confidential internal risk strategies
(D) By deducting the total market value of the bank's Tier-I capital from the gross exposure to simplify the calculation

May/June 2015

68. Omega Bank defines its activities and risk management practices as "simple." During its Internal Capital Adequacy Assessment Process (ICAAP) assessment, the management decides to solely project its business activities forward for the next 10 years and construct highly complex, non-linear stress test models. According to guidelines on ICAAP execution for simple banks, what would be a more appropriate approach?
- (A) To execute shock stress tests on all historical data without considering future business plans or potential market growth
(B) To completely outsource the ICAAP formulation process to foreign regulatory bodies and international financial consultants
(C) To focus only on developing back-testing systems for a 1-year horizon while ignoring the identification of significant risks
(D) To consider capital changes in line with 3-5 year business plans and assess largest losses over the last 3-5 years

Oct/Nov 2025

69. Match the items in List I with the corresponding items in List II.
List I: (Quantitative Disclosure Requirement)

- P. Amount of NPAs and past due loans broken down by significant geographic areas
Q. Capital requirements for equity position risk and foreign exchange risk
R. The approach(es) for operational risk capital assessment for which the bank qualifies
S. Gross positive fair value of contracts, netting benefits, netted current credit exposure

List II: (Table Number)

1. Table DF-7
2. Table DF-8
3. Table DF-10
4. Table DF-3
(A) P-3, Q-4, R-1, S-2
(B) P-4, Q-2, R-1, S-3
(C) P-1, Q-2, R-3, S-4
(D) P-4, Q-1, R-2, S-3

May/June 2018

70. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.
Assertion (A): The risk management function of banks must be independent of the business lines.
Reason (R): This independence is required to ensure an adequate separation of duties and to avoid conflicts of interest.
(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2017

71. Consider the following areas for additional disclosures for banks operating in India:
I. Securitisation exposures in the trading book
II. Sponsorship of off-balance sheet vehicles
III. Pipeline and warehousing risks with regard to securitisation exposures
Which of the above statement(s) is/are correct?
(A) I and II only
(B) II and III only
(C) I and III only
(D) I, II, and III

all regulatory adjustments in a consistent format.

- (C) To ensure that all banks report exactly the same profit margins across the financial sector.
- (D) To bypass the validation process typically conducted by the board of directors.

May/June 2014

62. What is the most appropriate description of the “Principle of Proportionality” in the implementation of the Internal Capital Adequacy Assessment Process (ICAAP)?
- (A) Banks must allocate an equal proportion of capital to credit, market, and operational risks regardless of actual exposure levels
 - (B) Supervisors must apply identical risk penalties to all banks proportionately based solely on their total reported asset value
 - (C) The sophistication of risk management should be commensurate with the nature, scale, and complexity of operations
 - (D) The board of directors must distribute proportional dividends to shareholders based on the capital ratio maintained

Oct/Nov 2021

63. Consider the following qualitative disclosures required under Table DF-6 (Securitisation Exposures):
- I. The bank’s objectives in relation to securitisation activity.
 - II. The various roles played by the bank in the securitisation process (e.g., originator, investor, servicer).
 - III. A description of the processes in place to monitor changes in the credit and market risk of securitisation exposures.
 - IV. The bank’s policy governing the use of credit risk mitigation to mitigate retained risks.
 - V. The exact names of all individual retail borrowers whose loans were securitized.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV only
 - (B) I, II, IV, and V only
 - (C) II, III, IV, and V only
 - (D) I, III, IV, and V only

May/June 2017

64. Consider the following key features of a sound risk management system under the Internal Capital Adequacy Assessment Process (ICAAP):

- I. Active board and senior management oversight
- II. Appropriate policies, procedures and limits
- III. Comprehensive and timely identification, measurement, mitigation, controlling, monitoring and reporting of risks
- IV. Appropriate management information systems (MIS) exclusively at the specific business line level, ignoring firm-wide aggregation
- V. Comprehensive internal controls

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV only
- (B) II, III, IV, and V only
- (C) I, II, III, and V only
- (D) I, III, IV, and V only

Oct/Nov 2022

65. Which of the following accurately describes a requirement under Table DF-9 concerning Interest Rate Risk in the Banking Book (IRRBB)?
- (A) The disclosure requires detailing the exact physical location of all bank branches and ATMs across both domestic and international markets
 - (B) It mandates qualitative disclosure on the nature of IRRBB and key assumptions, including loan prepayments and non-maturity deposits
 - (C) The quantitative disclosure must only reflect downward rate shocks, ignoring upward rate shocks entirely to simplify the reporting process
 - (D) The disclosure is strictly limited to currencies where the turnover is less than 1% of the total turnover.

May/June 2024

66. Consider the following statements regarding the Board of Directors’ responsibilities concerning a bank’s strategic plan under the Internal Capital Adequacy Assessment Process (ICAAP):
- I. The strategic plan must duly outline the bank’s current and future capital needs.
 - II. The strategic plan must outline the bank’s anticipated capital expenditure.
 - III. The strategic plan must detail the exact compensation packages for all junior employees.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only

NODIA

governance, risk management, and market discipline are fundamentally critical

- (D) It mandates that badly run banks must be immediately bailed out by the central bank using public funds to prevent systemic collapse

Oct/Nov 2019

35. Consider the following statements regarding quantitative and qualitative approaches in the Internal Capital Adequacy Assessment Process (ICAAP):

- I. All measurements of risk should incorporate both quantitative and qualitative elements.
- II. A quantitative approach should form the foundation of a bank's measurement framework.
- III. An increase in uncertainty related to modelling should result in a smaller capital cushion.
- IV. Quantitative approaches focusing on most likely outcomes for budgeting may not be fully applicable for capital adequacy.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) II, III, and IV only
- (C) I, II, and IV only
- (D) I, III, and IV only

May/June 2022

36. The following question consists of two statements — Assertion (A) and Reason (R). Answer the question by selecting the appropriate option.

Assertion (A): Banks are required to make Pillar 3 disclosures at least on a half yearly basis, irrespective of whether financial statements are audited, with exceptions for Capital Adequacy and specific Credit Risk disclosures which are required quarterly.

Reason (R): Frequent disclosures ensure that market participants have consistent and timely access to critical information regarding the bank's risk exposures and capital adequacy.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2012

37. What constitutes an "ICAAP Document" as submitted to the regulatory authority?

- (A) A brief summary limited to the bank's operational risk indicators for the previous quarter as reported to the senior management
- (B) A strictly quantitative ledger displaying only the minimum regulatory capital calculations required under the Pillar 1 framework
- (C) A public marketing brochure designed to attract potential shareholders by highlighting risk-free assets and stable growth patterns
- (D) A comprehensive paper on the ongoing assessment of the bank's risk spectrum, mitigating actions, and capital assessment

May/June 2021

38. Which of the following accurately describes the treatment of quantitative disclosures for Trading Book securitisation exposures as per Table DF-6?

- (A) The bank is only required to aggregate the amount of exposures securitised if it has transferred all risks entirely to third parties
- (B) Trading book disclosures require the publication of individual trader compensation packages and performance-based bonus structures
- (C) Aggregate the amount of exposures securitised with retained risk subject to the market risk approach, by exposure type
- (D) The bank must deduct all trading book exposures directly from Tier-II capital without any further categorization or breakdown

Oct/Nov 2020

39. While preparing the "Capital Adequacy" section of its Internal Capital Adequacy Assessment Process (ICAAP) document, Zeta Bank only presents the amount of capital required to meet minimum regulatory needs, ignoring any buffers needed to support its aggressive expansion plans into new emerging markets. Is this approach aligned with the outlined ICAAP document guidelines?

- (A) Yes, because the ICAAP document should strictly reflect Pillar 1 regulatory minimums as prescribed by the central banking

May/June 2006

72. Delta Bank operates in an environment where strategic plans and macroeconomic factors fluctuate frequently. The management drafted an Internal Capital Adequacy Assessment Process (ICAAP) document relying exclusively on past performance data from the previous decade, making no provision for future availability of capital. How does this approach conflict with ICAAP guidelines?

- (A) ICAAP must be forward-looking and take into account expected future developments and macroeconomic factors.
- (B) ICAAP should rely only on data from the past three years, not a full decade.
- (C) ICAAP should inherently assume that capital availability will infinitely expand to match historical growth.
- (D) ICAAP does not require any assessment of strategic plans unless instructed directly by the host country supervisor.

Oct/Nov 2008

73. A bank has recently experienced a major shift in its structural correlations due to a severe financial crisis. When updating the "Aggregation and Diversification" section of its Internal Capital Adequacy Assessment Process (ICAAP) document, how should the bank handle this event?

- (A) Document simulations to capture risks not well estimated, including shifts in correlations during a crisis period
- (B) Ignore the shift, as historical correlations are permanent and cannot be altered by temporary market fluctuations
- (C) Immediately classify all assets as non-performing and halt the ICAAP process until the market stabilizes
- (D) Remove the Aggregation and Diversification section entirely from the document to avoid any regulatory scrutiny

May/June 2010

74. What is the most appropriate reason for a bank to conduct stress testing and scenario analysis as part of its Internal Capital Adequacy Assessment Process (ICAAP)?

- (A) To guarantee that the bank's profits will increase consistently year over year.
- (B) To evaluate the potential vulnerability of the bank to some unlikely but plausible events

or movements in market conditions.

- (C) To satisfy the regulatory requirement of maintaining exactly 9% capital to risk-weighted assets ratio (CRAR) without holding any excess capital.
- (D) To shift the burden of capital planning from the senior management to the internal auditors.

Oct/Nov 2016

75. Match the items in List I with the corresponding items in List II.

List I: (Specific Disclosure Element in Table DF-3)

- P. Definitions of past due and impaired
- Q. Amount of NPAs (Gross)
- R. Opening balance, Additions, Reductions, Closing balance of NPAs
- S. Discussion of the bank's credit risk management policy

List II: (Disclosure Category)

- 1. Qualitative Disclosure
- 2. Quantitative Disclosure (Amount)
- 3. Quantitative Disclosure (Movement)
- 4. Qualitative Disclosure (Policy)

- (A) P-1, Q-2, R-3, S-4
- (B) P-4, Q-3, R-2, S-1
- (C) P-1, Q-3, R-2, S-4
- (D) P-2, Q-1, R-4, S-3

May/June 2009

76. When evaluating "Risk Aggregation and Diversification Effects" within the Internal Capital Adequacy Assessment Process (ICAAP), why must management be systematic and rigorous in documenting decisions and assumptions?

- (A) Because regulators prohibit the aggregation of credit and market risks under any circumstances to ensure granular reporting
- (B) Because banks are only permitted to aggregate risks if they have a conglomerate structure spanning multiple countries and regions
- (C) Because understanding challenges like data quality and correlation volatility is critical to accurately assessing bank-wide risk
- (D) Because the Basel-III framework strictly mandates the use of zero correlation (full diversification) across all risk types.

Oct/Nov 2019

77. Pacific Bank provides credit protection to a securitisation transaction through credit derivatives. Under which Pillar 3 disclosure table and section should the qualitative description of the bank's roles, and its policy governing the use of such credit risk mitigation, be detailed?
- (A) Table DF-2: Capital Adequacy (Quantitative) including all Tier-I and Tier-II components
 - (B) Table DF-6: Securitisation Exposures: Disclosure for Standardised Approach (Qualitative)
 - (C) Table DF-8: Operational Risk (Qualitative) focusing on internal loss data and systems
 - (D) Table DF-1: Scope of Application (Quantitative) covering all consolidated group entities

May/June 2022

78. Identify the incorrect statement regarding the "Executive Summary" section of the Internal Capital Adequacy Assessment Process (ICAAP) Document.
- (A) It includes the main findings of the ICAAP analysis, such as the composition of internal capital the bank considers it should hold.
 - (B) It provides a summary of the financial position of the bank, including its balance sheet strength and future profitability.
 - (C) It details the granular line-by-line historical transactional data of all off-balance sheet exposures over the past decade.
 - (D) It outlines brief descriptions of the capital raising and dividend plan.

Oct/Nov 2012

79. Consider the following general qualitative disclosure requirements with respect to derivatives and Counterparty Credit Risk (CCR) under Table DF-10:
- I. Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures.
 - II. Discussion of policies for securing collateral and establishing credit reserves.
 - III. Discussion of policies with respect to wrong-way risk exposures.
 - IV. Discussion of the impact of the amount of collateral the bank would have to provide given a credit rating downgrade.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only

- (B) II, III, and IV only
- (C) I, III, and IV only
- (D) I, II, III, and IV

May/June 2021

80. Consider the following regarding the "Methodology and Assumptions" section of the Internal Capital Adequacy Assessment Process (ICAAP) document:

- I. Banks may choose to base their ICAAP on the results of the capital to risk-weighted assets ratio (CRAR) calculation, with capital for additional risks assessed separately and added to the Pillar 1 computations.
- II. Where the bank uses an internal model, the section should explain the limitations of the model and the validation work undertaken.

Which of the above statement(s) is/are correct?

- (A) Only statement I is correct
- (B) Only statement II is correct
- (C) Both statements I and II are correct
- (D) Neither statement I nor II is correct

ANSWERS

1. (B) The ratio is calculated as Regulatory capital divided by only the risk-weighted assets for credit risk
Regulatory capital calculation under the Basel framework involves dividing the total regulatory capital by the sum of risk-weighted assets for credit, market, and operational risks. The statement suggesting that only credit risk is considered is inaccurate because the revised framework explicitly mandates capital allocation for multiple risk categories to ensure comprehensive coverage of a bank's potential exposures.
2. (B) Three to five years
Assessment of key sensitivities and future scenarios within the internal capital adequacy assessment process requires a forward-looking perspective. Banks are expected to project their financial positions over a medium-term horizon, typically spanning three to five years. This duration allows for a meaningful analysis of business plans, strategic objectives, and potential economic shifts while maintaining reasonable forecasting accuracy.
3. (A) A group of entities where a licensed bank is the controlling entity, including all group entities under its control except exempted ones
Capital adequacy norms define a consolidated bank as a group where a licensed bank acts as the controlling entity. This structure includes all group entities under its control, with specific exceptions for exempted ones like insurance subsidiaries. This approach ensures that capital requirements reflect the risks of the entire banking group rather than just the solo entity.
4. (D) I, II, III, IV, and V
The internal capital adequacy assessment process document explicitly requires the identification and analysis of several critical risks. These include credit, liquidity, and interest rate risk in the banking book, alongside reputational and pension obligation risks. Comprehensive assessment of these categories ensures that the bank maintains sufficient capital to withstand diverse financial pressures not fully addressed by minimum requirements.
5. (D) To allow banks to choose an approach commensurate with the stage of development of their operations
The revised framework provides banks with multiple options for calculating capital requirements for credit and operational risks. These approaches vary in complexity and risk-sensitivity to ensure that banks can adopt methods suitable for their developmental stage and operational scale. By offering this flexibility, regulators encourage financial institutions to transition toward more sophisticated and accurate risk management practices over time.
6. (C) It prohibits the assessment of the inherent uncertainty in any modelling approach when arriving at the overall capital assessment.
Technical aggregation in the internal capital adequacy assessment process should evaluate the inherent uncertainty of modeling approaches when determining overall capital needs. Denying this assessment is incorrect because modeling uncertainties significantly impact capital accuracy. The process must also justify diversification benefits and account for correlations between various risks to ensure the bank's aggregate risk profile is realistically represented.
7. (A) Only statement I is correct
Internal capital adequacy assessment processes are specifically designed to manage risks that minimum capital ratios under Pillar 1 may not fully capture. While this process is conducted at the consolidated level for banking groups, it is also required at the solo basis for each individual banking entity. This dual-level assessment ensures comprehensive risk management across all organizational layers.

management attention and capital consideration. Unlike credit or market risk, these exposures are handled through more qualitative assessments and specialized risk management strategies.

59. (B) I, II, III, and IV only

Quantitative disclosures under Table DF-3 require banks to report total gross credit risk exposures and their geographic distribution between domestic and overseas markets. They must also disclose the residual contractual maturity of assets and the specific categorization of non-performing assets. However, they should not disclose the names of individual defaulting customers to maintain borrower confidentiality.

60. (B) I, II, and IV only

The supervisory review process is based on principles that require banks to assess their own capital adequacy relative to their risk profiles. Supervisors evaluate these internal assessments and must intervene early if capital levels are at risk. Importantly, supervisors expect banks to operate above the minimum ratios, rather than exactly at them, to provide a safety buffer.

61. (B) To meet the Basel III requirement to disclose all regulatory adjustments in a consistent format.
 Basel III requires banks to use a common template for reporting regulatory capital to ensure consistency across the industry. This standardized format allows for clear disclosure of all regulatory adjustments and components. Using a uniform template helps market participants and supervisors compare capital structures between different banks easily, enhancing overall transparency and fostering effective market discipline.

62. (C) The sophistication of risk management should be commensurate with the nature, scale, and complexity of operations

The principle of proportionality states that the sophistication of a bank's risk management should match the nature, scale, and complexity of its operations. This means that larger or more complex institutions are expected to use more advanced assessment methods. It ensures that the regulatory burden and internal process requirements remain appropriate for the institution's specific risk profile.

63. (A) I, II, III, and IV only

Qualitative disclosures for securitisation require banks to describe their objectives, the various roles they play, and their monitoring processes for credit and market risks. They must also detail their policies for using credit risk mitigation. However, disclosing the names of individual retail borrowers is not required and would violate privacy norms and standard banking confidentiality practices for customers.

64. (C) I, II, III, and V only

A sound risk management system under the internal capital adequacy assessment process features active board oversight and comprehensive internal controls. It requires clear policies and procedures for identifying and monitoring risks. While management information systems are vital, they must provide firm-wide risk aggregation rather than focusing exclusively on individual business lines to ensure holistic institutional oversight.

65. (B) It mandates qualitative disclosure on the nature of IRRBB and key assumptions, including loan prepayments and non-maturity deposits
 Table DF-9 focuses on interest rate risk in the banking book, requiring qualitative disclosures on the nature of the risk and key assumptions. This includes modeling for loan prepayments and non-maturity deposits. By detailing these assumptions, banks provide transparency regarding how they measure and manage the impact of interest rate fluctuations on their financial stability.

66. (A) I and II only

The board of directors is responsible for ensuring that the bank's strategic plan outlines current and future capital needs. The plan must also detail anticipated capital expenditure to align financial resources with long-term goals. While strategic oversight is comprehensive, it does not typically involve detailing the exact compensation packages for all junior-level employees in the bank.

67. (A) By reporting total exposure after applicable netting and covered by eligible financial collateral after applying haircuts

Quantitative disclosures for credit risk mitigation require banks to report total exposure after

DF-3 provides general disclosures for credit risk across all banks. Table DF-6 is designated for securitisation exposures, and Table DF-9 addresses interest rate risk in the banking book. Precise mapping of these tables facilitates standardized market transparency and discipline.

17. (B) The risk of under-estimation of credit risk under the Internal Rating Based (IRB) approaches.

Model risk refers specifically to the potential for under-estimating credit risk when using the internal rating-based approaches allowed under the Basel framework. This risk arises from weaknesses in model design, data quality, or the assumptions used for risk calculation. Supervisors monitor this risk closely to ensure that internal models accurately reflect the bank's actual credit exposure and vulnerability.

18. (C) Materiality

Materiality is a key concept in financial disclosures that allows banks to omit information if its exclusion would not influence the decisions of a user. If data is deemed insignificant to the overall assessment of the institution's risk profile, it is considered non-material. This principle helps focus disclosures on the most relevant and impactful financial information for market participants.

19. (A) Settlement risk — part of operational risk
Settlement risk is a specialized form of credit risk arising from the failure of a counterparty to deliver on a contract. It is not categorized as part of operational risk. Other risks like credit concentration, liquidity, and strategic risk are correctly identified as components within the broader credit framework or Pillar 2 assessments within the regulatory structure.

20. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Market discipline serves as a critical component of a safe banking environment by acting as a disciplinary agent for financial institutions. By providing market participants with comprehensive and timely information, it empowers them to assess a bank's risk profile accurately. This transparency creates a salutary

effect, encouraging banks to maintain sound risk management and capital adequacy practices.

21. (D) To ensure it plays a role in credit decisions, product pricing, and general business expansion plans

The supervisory review process emphasizes the integration of the internal capital adequacy assessment process into a bank's decision-making culture. This ensures that capital considerations influence credit decisions, product pricing, and business expansion strategies. By embedding risk assessment into daily management, the institution can proactively maintain adequate capital levels that reflect its actual risk appetite and operational goals.

22. (C) Because accounting consolidation might include entities like insurance subsidiaries treated differently under regulatory frameworks
Banks must explain differences between accounting and regulatory consolidation because certain entities are treated differently under these frameworks. For example, insurance subsidiaries might be included in accounting reports but are often excluded or treated separately in regulatory capital calculations. Providing these explanations ensures transparency regarding the exact scope of assets and risks being assessed for capital adequacy.

23. (B) P-3, Q-4, R-1, S-2

A sound internal capital adequacy assessment process involves distinct structural aspects with specific features. Board oversight focuses on setting risk tolerance and strategic planning. Senior management ensures an integrated perspective on emerging risks. Policies and controls provide for the identification and monitoring of risks, while internal controls require independent testing to avoid potential conflicts of organizational interest.

24. (A) Table DF-8 — Interest Rate Risk in the Banking Book (IRRBB)

Table DF-8 is designated for operational risk disclosures rather than interest rate risk in the banking book. Interest rate risk is actually covered under Table DF-9. Correctly identifying these tables is essential for maintaining the standardized reporting structure required under Pillar 3, which aims to provide market participants

assets from the opening to the closing balance is classified as a quantitative movement disclosure for reporting.

- 76.** (C) Because understanding challenges like data quality and correlation volatility is critical to accurately assessing bank-wide risk

Systematic and rigorous documentation of risk aggregation decisions is essential for accurately assessing a bank-wide risk profile. Understanding challenges like data quality and correlation volatility is critical for this process. Management must justify their assumptions to ensure that the resulting capital assessment is reliable and reflects the institution's actual vulnerability across different business lines.

- 77.** (B) Table DF-6: Securitisation Exposures: Disclosure for Standardised Approach (Qualitative)

Credit protection provided through derivatives in a securitisation transaction must be disclosed under Table DF-6. This table covers securitisation exposures and requires a qualitative description of the bank's roles and its mitigation policies. Proper disclosure in this section ensures transparency regarding the specific risks and roles the bank assumes within the securitisation market and its associated frameworks.

- 78.** (C) It details the granular line-by-line historical transactional data of all off-balance sheet exposures over the past decade.

The executive summary of the internal capital adequacy assessment process document should highlight main findings, financial positions, and capital plans. It provides an overview of the bank's balance sheet strength and dividend strategies. However, it should not include granular, line-by-line historical transactional data, as such level of detail is inappropriate for an executive-level summary.

- 79.** (D) I, II, III, and IV

Table DF-10 requires qualitative disclosures regarding counterparty credit risk, including methodologies for assigning economic capital and credit limits. Banks must also discuss policies for securing collateral and managing wrong-way risk. Additionally, they must outline the impact of credit rating downgrades on the amount of

collateral they would be required to provide to counterparties.

- 80.** (C) Both statements I and II are correct

The methodology and assumptions section of the internal capital adequacy assessment process document should explain the use of internal models and their limitations. Banks may base their assessment on regulatory capital ratios while assessing additional risks separately. This transparency regarding modeling and validation work ensures that supervisors can evaluate the reliability of the bank's internal assessment process.

- 33.** (B) Focus more on qualitative assessment, risk management, and mitigation rather than strict quantification.
Some risks, such as reputation and strategic risks, are inherently difficult to quantify into precise financial metrics. In such cases, the internal capital adequacy assessment process guidelines suggest focusing on qualitative assessment, management, and mitigation strategies. Banks should not exclude these risks entirely; instead, they must demonstrate how these exposures are being monitored and controlled within their framework.
- 34.** (C) It highlights that while capital is necessary, governance, risk management, and market discipline are fundamentally critical
The philosophy that capital cannot rescue a badly run bank highlights the fundamental importance of governance and risk management. While maintaining adequate capital is a regulatory requirement, it is the quality of management and internal controls that ultimately determines a bank's survival. Capital serves as a buffer, but sound operational practices are the primary defense against institutional failure.
- 35.** (C) I, II, and IV only
Measurements of risk within the internal capital adequacy assessment process should integrate both quantitative and qualitative elements. While quantitative methods form the foundation, they may not be fully applicable for capital adequacy if they focus only on likely outcomes. Furthermore, increased uncertainty in modeling should result in a larger capital cushion rather than a smaller one.
- 36.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Pillar 3 disclosures are generally required on a half-yearly basis to provide market participants with timely information. However, critical data regarding capital adequacy and specific credit risk exposures must be disclosed quarterly. This frequent reporting ensures consistent access to the bank's risk status, regardless of whether the interim financial statements have undergone a full external audit.
- 37.** (D) A comprehensive paper on the ongoing assessment of the bank's risk spectrum, mitigating actions, and capital assessment
The internal capital adequacy assessment process document is a comprehensive paper detailing a bank's ongoing risk assessment and capital needs. It goes beyond simple quantitative ratios to describe mitigating actions and the overall risk spectrum. This document serves as a central tool for both the bank's management and the regulatory authority to monitor financial health.
- 38.** (C) Aggregate the amount of exposures securitised with retained risk subject to the market risk approach, by exposure type
For trading book securitisation exposures, banks must aggregate the amount of exposures where risk is retained and subject to the market risk approach. These disclosures should be broken down by exposure type. This requirement ensures transparency regarding the specific risks a bank continues to hold in its trading portfolio after securitising various assets for its customers.
- 39.** (B) No, the document must state if capital represents minimum regulatory needs or capital required for actual business plans
Internal capital adequacy assessment guidelines require banks to explicitly state whether their capital represents the minimum regulatory needs or the capital required for actual business plans. Omission of capital needed for expansion plans is incorrect because the document must reflect the bank's forward-looking strategic objectives. This clarity allows for a more realistic assessment of future capital sustainability.
- 40.** (D) I, II, III, IV, and V
The summary section of the internal capital adequacy assessment process document must encompass the bank's current financial position and its environment. It should also detail expected changes to the business profile, projected business plans by line, and planned future sources of capital. Including all these elements provides a holistic view of the institution's current and future capital strength.
- 41.** (A) I and II only
Assessment of securitisation within a firm-wide risk oversight framework involves analyzing the credit quality and risk characteristics of

8. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Compensation practices in banking must align with long-term capital preservation and financial stability. Consequently, the internal capital adequacy assessment process document should clearly disclose how risk-adjusted performance measures for employees are linked to their compensation. This transparency ensures that incentives do not encourage excessive risk-taking that could jeopardize the firm's capital strength and overall financial health.
9. (A) II, III, IV, I
Capital adequacy frameworks evolved through specific historical milestones. The process began with the Basel-I accord setting asset-based capital standards. This was followed by a revision exercise addressing initial limitations, which eventually led to the finalization of the revised framework. The comprehensive version of this framework was then issued to enhance risk management practices across the entire global banking sector.
10. (B) Guarantees that management actions will eliminate the need for Tier-I capital
Management actions in the internal capital adequacy assessment process should quantify impacts on capital ratios and include sensitivity testing under stressed scenarios. However, management cannot provide absolute guarantees that these actions will eliminate the need for Tier-I capital. The document must also show revised figures excluding these actions to demonstrate the gross risk faced by the bank.
11. (A) The accord restricts home country supervisors from leading enhanced cooperation with host country supervisors.
The Basel-III framework promotes enhanced cooperation between home and host country supervisors rather than restricting it. This collaborative approach is a fundamental component of the three-pillar structure. The framework also introduces capital allocation for operational risks and aligns regulatory capital with internal risk profiles, encouraging banks to invest in sophisticated internal systems to manage their diverse risk exposures.
12. (A) I and II only
Integrating the internal capital adequacy assessment process into a bank's daily operations involves using it for setting prices and charges. Furthermore, future business volume and nature serve as vital indicators for capital management. Contrary to separating the process from operating philosophy, the document should reflect the actual capital management strategies and business plans used by the bank.
13. (A) I and II only
Total risk-weighted assets are determined by incorporating credit, market, and operational risks. For market and operational risks, the capital requirement is multiplied by a factor of 12.5 to convert absolute charges into risk-weighted equivalents. This methodology ensures that all three major risk categories are treated consistently within the regulatory framework for assessing a bank's capital adequacy.
14. (C) Information on products or systems that, if shared, would render a bank's investment less valuable and undermine its position
Proprietary information within the Pillar 3 framework refers to data concerning products or systems that could diminish a bank's competitive advantage if disclosed. Sharing such details could make investments less valuable or undermine the institution's market position. Consequently, banks are allowed to maintain confidentiality for these specific items to protect their commercial interests and strategic assets.
15. (D) The bank should hold additional capital under Pillar 2, as these risks are not fully captured in the regulatory CRAR
Risks such as reputational challenges and settlement delays are often not fully captured by the standard capital charges under Pillar 1. Under the supervisory review process, banks are expected to hold additional capital for these specific exposures. Addressing these gaps under Pillar 2 ensures that the bank's total capital reflects its unique risk profile beyond regulatory minimums.
16. (D) P-4, Q-2, R-1, S-3
Regulatory disclosure tables follow a specific numbering system to ensure consistency. Table DF-2 covers capital adequacy, while Table

- 50.** (C) The insurance subsidiary should be excluded from the consolidated bank group for capital adequacy purposes.
For consolidated capital adequacy purposes, insurance subsidiaries are generally excluded from the banking group. This exclusion is due to the different risk profiles and regulatory frameworks governing the insurance industry compared to traditional banking. Separating these entities ensures that the banking group's capital ratio accurately reflects the specific risks associated with its financial and banking operations.
- 51.** (A) Details of the reliance placed on any external service providers or consultants in the testing process should be detailed in the document.
If a bank utilizes external consultants for testing or scenario generation in its internal capital adequacy assessment process, it must detail this reliance in its documentation. Transparency regarding the use of external service providers ensures that supervisors can evaluate the independence and quality of the testing process. This requirement keeps the board informed and accountable.
- 52.** (D) Subordinated debt, loan loss reserves, and limited life preference shares with more than five years' maturity
Tier-II capital, also known as supplementary capital, includes components like subordinated debt and loan loss reserves. It also encompasses limited life preference shares with a maturity exceeding five years. These instruments provide a secondary layer of protection for depositors and help the bank absorb losses while continuing its operations under various stressed financial market conditions.
- 53.** (B) Principle 3: Disclosures should be meaningful to users.
The Basel Committee established guiding principles for Pillar 3 disclosures to enhance market transparency. Principle 3 specifically states that disclosures should be meaningful to users, ensuring the information provided is relevant for assessment. Other principles emphasize that disclosures should be comprehensive, comparable across institutions, and clear to all market participants for effective market discipline.
- 54.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
Basel III guidelines successfully phased out Tier-III capital, which was originally introduced under previous frameworks to address market risks. While both the assertion regarding the phase-out and the reason regarding its original purpose are true, the purpose itself is not the primary reason for the removal. The removal aimed to improve the overall quality and permanence of capital.
- 55.** (B) Pillar 3 applies at the top consolidated level; disclosures for individual banks within the group are generally not required
Pillar 3 disclosure requirements generally apply at the top consolidated level of a banking group. This means that individual banks within a larger group are typically not required to publish separate disclosures. Centralizing these reports at the parent level provides a comprehensive view of the group's risk profile while reducing the administrative burden on individual subsidiaries.
- 56.** (A) Foreign exchange risk under the Standardised duration approach
Pillar 2 addresses risks not fully captured by the standard Pillar 1 charges, such as liquidity risk, credit concentration risk, and interest rate risk in the banking book. Foreign exchange risk under the standardized duration approach is already a component of the Pillar 1 market risk framework. Therefore, it is not an example of an uncaptured risk.
- 57.** (A) Only statement I is correct
Pillar 3 disclosures must undergo adequate validation to ensure consistency with audited financial statements. While internal validation is mandatory, there is no universal requirement for all Pillar 3 disclosures to be externally audited unless they are part of the annual financial report. This principle ensures that the information provided to the market is reliable and accurate.
- 58.** (B) Reputational risk — Categorised as a Pillar 2 risk
Under the internal capital adequacy assessment process framework, reputational risk is specifically categorized as a Pillar 2 risk. This classification recognizes that such risks are difficult to quantify but still require significant

with clear and consistent information about bank risks.

- 25.** (A) No, because the ultimate responsibility for designing and implementing the ICAAP lies with the bank's board of directors.

Supervisory guidelines mandate that the ultimate responsibility for designing and implementing the internal capital adequacy assessment process rests with the bank's board of directors. The board cannot delegate this duty entirely to executive officers like the chief risk officer. They must remain actively involved in reviewing and approving the document to ensure effective oversight of the institution's capital.

- 26.** (B) The proprietary algorithms utilized by the rating agencies

Qualitative disclosures for standardized portfolios require banks to name the external credit rating agencies used and the types of exposures assigned to each. While banks must explain changes in the agencies used, they are not required to disclose the proprietary algorithms of those agencies. Such algorithms are intellectual property and are not necessary for regulatory market transparency.

- 27.** (A) MIS must provide regular, accurate, and timely information on the bank's aggregate risk profile for proactive management

Management information systems are required to provide the board and senior management with regular, accurate, and timely data regarding the bank's aggregate risk profile. This enables proactive risk management and oversight. MIS should not obscure assumptions or limit reporting only to credit risk, as comprehensive coverage of all material risks is essential for a sound capital assessment.

- 28.** (C) If sales and transfers from HTM exceed 5% of its book value at the beginning of the year
Regulatory requirements trigger specific disclosures regarding the market value of held to maturity investments when sales or transfers from this category exceed five percent of its book value at the year's beginning. In such cases, the bank must indicate the excess of book value over market value. This ensures transparency when significant movements occur within stable portfolios.

- 29.** (B) Estimating the range and distribution of possible losses using shock stress tests.

Moderately complex banks performing their internal capital adequacy assessment must go beyond simple expectations. They should estimate loss distributions using shock stress tests and project business activities over a multi-year horizon. Assuming that business develops exactly as expected without considering adverse scenarios is inappropriate, as stress testing is a fundamental requirement of the capital assessment process.

- 30.** (B) The bank should make suitable disclosures regarding the material divergences in its published financial statements.

Transparency requirements dictate that material divergences in non-performing assets identified by the regulator must be disclosed in the bank's financial statements. Specifically, if the regulator's findings exceed fifteen percent of the published incremental gross NPAs, suitable disclosures are mandatory. This ensures that investors and depositors have an accurate understanding of the bank's asset quality and potential risks.

- 31.** (C) Both statements I and II are correct

The internal capital adequacy assessment process must undergo regular and independent reviews through internal or external audit functions. These reviews are essential for ensuring that the process remains robust and effectively identifies risks like concentration risk in a timely manner. Consistent validation helps maintain the integrity of the bank's internal models and its overall capital management framework.

- 32.** (A) I, II, and III only

Banks are required to publish the full terms and conditions of their regulatory capital instruments on their websites. This transparency allows both supervisors and market participants to investigate the specific features of these instruments. Maintaining this information in the prescribed form ensures that the public can accurately assess the quality and permanence of the bank's capital base.

applicable netting and coverage by eligible financial collateral. This reporting must account for any haircuts applied to the collateral value. Providing these net figures allows market participants to understand the actual residual risk the bank faces after its various risk mitigation strategies are considered.

68. (D) To consider capital changes in line with 3-5 year business plans and assess largest losses over the last 3-5 years

Simple banks should adopt an internal capital adequacy assessment approach that aligns with their operational complexity. Instead of complex non-linear models, they should focus on assessing changes in capital relative to three-to-five-year business plans. Evaluating the largest losses experienced over a similar historical period is a more appropriate and practical method for banks with straightforward profiles.

69. (D) P-4, Q-1, R-2, S-3

Disclosure tables are specifically numbered for different risk categories. Table DF-3 covers credit risk movements and geographic distributions, while Table DF-7 addresses market risk capital requirements. Table DF-10 is used for counterparty credit risk and contracts. Precise mapping of these elements ensures that banks meet the standardized reporting requirements designed to promote transparency and market discipline.

70. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

The risk management function in a bank must remain independent from its business lines to ensure a proper separation of duties. This independence is crucial for avoiding conflicts of interest that could arise if those taking risks were also responsible for measuring them. Both the assertion and the reason are true and correctly explain the regulatory requirement.

71. (D) I, II, and III

Banks in India are required to provide additional disclosures regarding securitisation exposures in the trading book and the sponsorship of off-balance sheet vehicles. They must also disclose pipeline and warehousing risks related to these exposures. These requirements ensure

that supervisors and market participants have a complete understanding of the bank's involvement in complex financial structures.

72. (A) ICAAP must be forward-looking and take into account expected future developments and macroeconomic factors.

The internal capital adequacy assessment process must be forward-looking and incorporate expected future developments and macroeconomic factors. Relying solely on historical data without considering future capital availability or strategic plans conflicts with regulatory guidelines. This forward-looking approach ensures that the bank is prepared for upcoming risks and can sustain its capital adequacy through changing economic cycles.

73. (A) Document simulations to capture risks not well estimated, including shifts in correlations during a crisis period

When structural correlations shift during a financial crisis, banks should document simulations to capture risks that are not well estimated by standard models. This is particularly important for the aggregation and diversification section of the internal capital adequacy assessment. Recognizing that correlations can change under stress helps ensure the bank's overall risk assessment remains realistic and robust.

74. (B) To evaluate the potential vulnerability of the bank to some unlikely but plausible events or movements in market conditions.

Stress testing and scenario analysis are used to evaluate a bank's potential vulnerability to unlikely but plausible market events. The objective is to understand the impact of adverse conditions on the bank's capital and financial health. This process helps senior management identify potential weaknesses and develop appropriate contingency plans to maintain institutional stability.

75. (A) P-1, Q-2, R-3, S-4

Table DF-3 includes various disclosure categories to provide a comprehensive view of credit risk. Definitions and management policies are qualitative disclosures. The actual amount of gross non-performing assets is a quantitative disclosure. Tracking the movement of these

underlying exposures. It also requires explaining the maturity of these exposures relative to the liabilities issued. Banks must continue monitoring changes in the market risk of these exposures rather than eliminating such requirements to ensure comprehensive risk management and oversight.

- 42.** (B) To ensure that banks have adequate capital to support all risks and encourage better risk management techniques

The primary objective of the supervisory review process, or Pillar 2, is to ensure that banks maintain adequate capital to support all material risks. This process encourages the development and use of better risk management techniques. It allows supervisors to evaluate internal assessments and intervene if a bank's capital is insufficient for its risk profile.

- 43.** (A) III, II, I, IV

An illustrative internal capital adequacy assessment process document typically begins with an executive summary, followed by background information. The document then presents a summary of the current and projected financial and capital positions. Finally, it addresses the specific capital adequacy assessment. This logical structure helps present a clear and comprehensive view of institutional risk management and capital planning.

- 44.** (C) Co-operative Banks, Local Area Banks, and Regional Rural Banks

While capital adequacy norms apply broadly to commercial banks, certain institutions like co-operative banks, regional rural banks, and local area banks are governed by separate regulatory frameworks. Standard Basel-based norms for commercial banks generally exclude these categories. This distinction ensures that regulatory requirements remain appropriate for the specific nature and scale of different types of financial institutions.

- 45.** (B) By comparing them with capital planning analysis and senior management's view on the overall level of appropriate capital

To evaluate the overall reasonableness of quantification approaches, a bank should compare its internal models with its capital planning analysis. Senior management's

perspective on the appropriate level of capital also provides a critical benchmark. This multi-faceted evaluation ensures that technical results align with the bank's actual business realities, strategic objectives, and overall risk appetite.

- 46.** (C) P-1, Q-2, R-3, S-4

Capital assessment for different risks involves various methodological options. The standardized approach is a common option for credit risk, while the basic indicator approach is the simplest method for operational risk. For advanced risk management, the internal models approach is used for market risk, and the advanced measurement approach is used for operational risk.

- 47.** (D) The bank is non-compliant, as details of any restrictions on the management's ability to transfer capital into or out of the banking business must be furnished.

Banks are required to furnish details of any legal or regulatory restrictions on the transfer of capital into or out of their business entities. Failing to disclose that a host-country regulator limits capital transfers makes the bank non-compliant with internal capital adequacy guidelines. This information is vital for assessing the consolidated group's actual capital mobility and stability.

- 48.** (D) The total capital ratio must not be lower than 8% globally and is prescribed at 9% in India.

Under the current Basel III guidelines, the total capital ratio is prescribed at nine percent in India, which is higher than the eight percent global minimum. Additionally, Tier-III capital has been phased out. These requirements ensure that banks maintain a robust capital base to absorb potential losses from various credit, market, and operational risk exposures.

- 49.** (A) I, II, and III only

An internal capital adequacy assessment must evaluate how economic downturns affect the bank's future earnings and capital funds. It also considers the impact on the capital to risk-weighted assets ratio, accounting for projected balance sheet changes. Such assessments do not typically focus on the complete cessation of lending operations as a standard requirement for these simulations.

CHAPTER 28

Asset Classification and Provisioning Norms

May/June 2018

1. NARCL purchases a bad loan from a commercial bank for an agreed price of ₹100 Crores. NARCL immediately pays the bank in cash. According to the bad bank operational structure, what is the exact amount of cash the commercial bank will receive upfront?
- (A) ₹15 Crores
(B) ₹50 Crores
(C) ₹85 Crores
(D) ₹100 Crores

Oct/Nov 2024

2. Which of the following pairs correctly matching the SMA sub-category to its classification basis is incorrect?
- (A) SMA-0 : Principal or interest payment not overdue for more than 30 days but showing signs of incipient stress.
(B) SMA-1 (non-revolving) : Principal or interest payment overdue between 31 - 60 days.
(C) SMA-1 (revolving) : Outstanding balance remains continuously in excess of sanctioned limit for 1 - 30 days.
(D) SMA-2 (non-revolving) : Principal or interest payment overdue between 61 - 90 days.

May/June 2005

3. An account should be treated as 'out of order' if:
- (A) The outstanding balance remains continuously in excess of the sanctioned limit or drawing power.
(B) The bill remains overdue for a period of more than 90 days from the original date of purchase.
(C) The installment of principal or interest thereon remains overdue for at least one full crop season.
(D) The amount of liquidity facility remains outstanding for more than 90 days after the original drawdown.

Oct/Nov 2013

4. Consider the following statements regarding the upgradation of MSME loan accounts classified as NPAs:
- I. An account may be considered for upgradation to 'standard' only if it demonstrates satisfactory performance during the specified period of one year.
II. Satisfactory performance means that no payment shall remain overdue for a period of more than 60 days.
- Which of the above statement(s) is/are correct?
- (A) Only I
(B) Only II
(C) Both I and II
(D) Neither I nor II

May/June 2019

5. A loss asset is one where:
- (A) The asset has remained in the substandard category for a period of exactly 12 months from classification.
(B) The realisable value of the security is less than 50 per cent of the value recently assessed by the bank.
(C) The arrears of interest and principal are partially paid by the borrower without regularising the account.
(D) Loss has been identified by the bank or auditors/inspectors but not yet written off wholly.

Oct/Nov 2007

6. Consider the following statements regarding accounts with erosion in the value of security:
- I. If the realisable value of the security is less than 50 per cent of the value assessed by the bank, the NPA may be straightaway classified under the doubtful category.
II. If the realisable value of the security is less than 10 per cent of the outstanding in the borrowal accounts, the asset should be

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Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

Oct/Nov 2014

56. Which of the following represents the correct treatment for credit card accounts?

- (A) The account becomes NPA if the minimum amount due is not paid within 90 days from the due date.
- (B) The account becomes an NPA if the full billed amount is not paid within 90 days of the statement date.
- (C) Credit card accounts are exempt from standard NPA classification norms due to their unsecured revolving nature.
- (D) The account is treated as an NPA immediately upon rolling over the balance to the subsequent billing cycle.

May/June 2019

57. Analyze the following statements regarding asset classification being borrower-wise and not facility-wise:

- I. All facilities granted by a bank to a borrower must be treated as NPA if any one facility becomes a problem credit.
- II. Debits arising out of devolvement of letters of credit parked in a separate account must be treated as part of the principal operating account.
- III. Bills discounted under LC favouring a borrower are classified as NPA immediately if any other facility is NPA, even before presentation.
- IV. For derivative contracts, overdues from forward contracts turning NPA cause all other funded facilities of the client to be classified as NPA.
- V. Overdue receivables from foreign exchange derivative contracts entered between April 2007 to June 2008 will not make other funded facilities NPA.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2023

58. Which of the following statements regarding consortium arrangements is incorrect?

- (A) Asset classification of accounts under consortium should be based on the record of recovery of individual member banks.
- (B) If a bank receives remittances and does not part with the share of other member banks, the account is treated as serviced in the books of the other banks.
- (C) Participating banks should arrange to get their share of recovery transferred from the lead bank.
- (D) Proper asset classification requires banks to get an express consent from the lead bank for the transfer of their share of recovery.

May/June 2022

59. Review the following statements about additional provisions when a viable Resolution Plan (RP) is not implemented:

- I. Lenders must make an additional provision of 20% if the RP is not implemented within 180 days from the end of the Review Period.
- II. Lenders must make a total additional provision of 35% if the RP is not implemented within 365 days from the commencement of the Review Period.
- III. The total provisions held are capped at 100% of the total outstanding.
- IV. These additional provisions are made over and above the provisions required as per the asset classification status.
- V. The process of implementing an RP must strictly be initiated only after a formal default has occurred.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) I, II, III, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

Oct/Nov 2020

60. Which of the following statements regarding the upgradation of loan accounts classified as NPAs (for non-MSME accounts) is incorrect?

- (A) Standard accounts classified as NPA may be upgraded when all facilities demonstrate satisfactory performance during the monitoring period.
- (B) At least 10 per cent of the sum of outstanding debt and interest capitalisation must be

Oct/Nov 2019

- 14.** Review the following statements about income recognition of projects under implementation:
- I. Banks may recognise income on an accrual basis for projects classified as 'standard'.
 - II. Banks cannot recognise income on an accrual basis for projects classified as 'substandard'.
 - III. If funded interest on NPAs is recognised as income, a provision for an equal amount should simultaneously be made.
 - IV. Interest income converted into quoted equity can be recognised at market value, exceeding the amount of interest converted.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
 - (B) I, II, and IV
 - (C) II, III, and IV
 - (D) I, II, III, and IV

May/June 2025

- 15.** How should banks treat interest on advances against term deposits, NSCs, IVPs, KVPs, and life policies?
- (A) It must be booked only when actually received, regardless of the margin availability or security value.
 - (B) It must be reversed at the end of every financial year if not paid by the borrower by the due date.
 - (C) It is subject to a mandatory 90-day delinquency norm before any recognition in the bank's income accounts.
 - (D) It may be taken to income account on the due date if adequate margin is available.

Oct/Nov 2006

- 16.** Consider the following rules regarding credit card accounts:
- I. The amount spent is billed to users through a monthly statement with a definite due date.
 - II. Banks give an option to pay either the full amount or a minimum amount due.
 - III. The account becomes NPA if the minimum amount due is not paid fully within 90 days from the payment due date.
 - IV. This uniform method is only for internal classification and not for reporting to credit information companies.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III

- (B) I, II, and IV
- (C) II, III, and IV
- (D) I, III, and IV

May/June 2012

- 17.** Regarding income recognition for projects under implementation, which statement is accurate?
- (A) Banks may recognise income on an accrual basis in respect of projects classified as a 'substandard' asset.
 - (B) Banks may recognise income on an accrual basis in respect of projects classified as 'standard'.
 - (C) Funded interest recognised as income in respect of NPAs does not require any simultaneous provision.
 - (D) Interest income on zero coupon bonds arising from conversion of NPA interest can be recognised immediately.

Oct/Nov 2014

- 18.** Evaluate the following guidelines for transactions involving direct assignment of cash flows:
- I. The originating bank may maintain a consolidated account for the MRR if the transferred loans are retail loans.
 - II. For non-retail loans, the originator must maintain borrower-wise accounts for proportionate amounts retained.
 - III. The purchasing bank must apply asset classification and provisioning norms based on individual obligors.
 - IV. The purchasing bank is permitted to apply provisioning norms at the portfolio level to streamline credit supervision.
 - V. The guidelines do not apply to inter-bank participations or trading in bonds.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and V
 - (B) I, II, IV, and V
 - (C) II, III, IV, and V
 - (D) I, III, IV, and V

May/June 2023

- 19.** Which of the following statements regarding government guaranteed advances is incorrect?
- (A) State Government guaranteed advances do not attract asset classification and provisioning norms under any circumstances.
 - (B) Credit facilities backed by guarantee of the

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power or stock reports.

- (D) The installment of principal or interest remains overdue for two crop seasons for short duration crops.

May/June 2009

43. Consider the following statements regarding agricultural advances:

- I. A loan granted for short duration crops will be treated as NPA if the instalment of principal or interest thereon remains overdue for two crop seasons.
- II. The crop season for each crop is determined by the relevant regulator on a national basis.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2019

44. An asset is classified as a doubtful asset if it:
- (A) Ceases to generate income for the bank for a period of 90 days.
 - (B) Has been identified as a loss by the bank but the amount has not been written off wholly.
 - (C) Has remained in the substandard category for a period of 12 months.
 - (D) Has been in default for a period of more than two crop seasons.

May/June 2025

45. Consider the following statements regarding derivative contracts:

- I. Overdue receivables representing the positive mark-to-market value of a derivative contract are treated as NPA if unpaid for 90 days or more.
- II. If the overdues arise from forward contracts and plain vanilla swaps, all other funded facilities granted to the client shall not be classified as NPA.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

Oct/Nov 2007

46. In which month and year was the high-level committee headed by M. Narasimham

appointed to examine various aspects of the financial system?

- (A) April 1990
- (B) August 1991
- (C) March 1993
- (D) November 2008

May/June 2014

47. Identify the correct combination of statements regarding the reversal of income:

- I. Interest accrued and credited to income account in the corresponding previous year should be reversed if the advance becomes NPA and the interest is not realised.
- II. Fees and commission that have accrued on NPAs should cease to accrue in the current period.
- III. The reversal of income rules do not apply to government guaranteed accounts under any circumstances.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2016

48. What is the provisioning requirement for unsecured 'doubtful' assets?

- (A) 25 per cent
- (B) 40 per cent
- (C) 50 per cent
- (D) 100 per cent

May/June 2018

49. Consider the following statements concerning Takeout Finance and Post-shipment Supplier's Credit:

- I. Under takeout finance, the lending institution should recognize income on accrual basis even if the asset has turned NPA on the record of recovery.
- II. In post-shipment credit, to the extent payment is received from the relevant export-import institution under a guarantee programme, the advance may not be treated as an NPA.
- III. The taking over institution in a takeout finance arrangement should make provisions treating the account as NPA from the actual date of it becoming NPA.

Which of the above statement(s) is/are correct?

- (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

May/June 2011

25. Which of the following is NOT provided as a non-exhaustive indicative sign of financial difficulty under the framework for resolution of stressed assets?
- (A) A borrower's outstanding securities have been listed on a new international exchange.
 (B) A default, as per the definition provided in the framework.
 (C) A borrower's existing exposures are categorised as having already evidenced difficulty in ability to repay.
 (D) A pattern of delinquency in payments on exposures, making a future default probable.

Oct/Nov 2012

26. The following question consists of two statements, an Assertion (A) and a Reason (R). Select the correct answer using the options provided below:
 Assertion (A): Banks are often advised to achieve a total Provisioning Coverage Ratio (PCR) of not less than 70 per cent.
 Reason (R): A higher PCR acts as a macro-prudential buffer built up during good times that can be used for absorbing losses in a downturn, thereby enhancing financial stability.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 (C) Assertion (A) is true, but Reason (R) is false.
 (D) Assertion (A) is false, but Reason (R) is true.

May/June 2015

27. What is the correct treatment for the overdue receivables representing the positive mark-to-market value of a derivative contract?
- (A) They are treated as a non-performing asset if they remain unpaid for 90 days or more.
 (B) They are ignored for asset classification purposes as they represent unrealized gains.
 (C) They are capitalized and added to the principal outstanding of the cash credit facility.
 (D) They are classified as doubtful assets immediately upon becoming overdue.

Oct/Nov 2013

28. Read the following scenario and answer the question:
A farmer secured an agricultural loan for raising sugarcane, which takes approximately 14 months to harvest. The installment for this loan has been overdue for one and a half crop seasons.
 According to the prescribed asset classification norms, what is the status of this loan?
- (A) It is an NPA, because the crop is a short duration crop and has exceeded one crop season in default.
 (B) It is a standard asset, because for a long duration crop, the installment must remain overdue for more than two crop seasons to become NPA.
 (C) It is an NPA, because sugarcane is long duration, and the loan becomes NPA if the installment remains overdue for one season.
 (D) It is a standard asset, because the full two seasons required for long duration crops have not yet elapsed under rules.

May/June 2008

29. In the context of reviewing borrower accounts for potential stress, what is the duration of the "Review Period" to undertake a prima facie review of the account?
- (A) Fifteen days from the date of default
 (B) Thirty days from the date of default
 (C) Sixty days from the date of default
 (D) Ninety days from the date of default

Oct/Nov 2017

30. Read the following scenario and answer the question:
A large borrower has a working capital limit of ₹10 Crores. The borrower submits a stock statement dated 1st January. By 15th May of the same year, no new stock statements have been provided, and drawings have continued. The outstanding balance relies on the drawing power calculated from the January statement.
 What is the status of these drawings and the potential NPA classification?
- (A) The drawings are valid until the end of the financial year, averting any NPA classification for this period.
 (B) The account immediately becomes a Loss Asset because the stock statement provided is older than three months.
 (C) The drawings are irregular; if permitted

straightaway classified as a loss asset.

Which of the above statement(s) is/are correct?

- (A) Only I
- (B) Only II
- (C) Both I and II
- (D) Neither I nor II

May/June 2021

7. For Micro, Small and Medium Enterprises (MSME) accounts to be considered for upgradation to 'standard', what is the threshold for the aggregate exposure of the lenders?

- (A) Less than ₹10 crores
- (B) Less than ₹25 crores
- (C) Less than ₹50 crores
- (D) Less than ₹100 crores

Oct/Nov 2016

8. Consider the following statements regarding indicators of financial difficulty under the restructuring of advances:

- I. A default, irrespective of the reasons, shall be treated as an indicator of financial difficulty.
- II. A borrower's outstanding securities being delisted or under threat of delisting is considered an indicator.
- III. A borrower whose credit facilities are in non-performing status is excluded from the definition of financial difficulty.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2010

9. What is the general provisioning rate required for standard advances to the Commercial Real Estate (CRE) Sector?

- (A) 0.25 per cent
- (B) 0.40 per cent
- (C) 0.75 per cent
- (D) 1.00 per cent

Oct/Nov 2025

10. Evaluate the following statements regarding provisioning norms for all cases of fraud:

- I. Banks must immediately provide for the entire amount due upon detection of a fraud.
- II. Banks have the option to make the provisions

over a period not exceeding four quarters.

III. Banks are permitted to adjust financial collateral eligible under capital regulations while computing the provisioning requirement.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2014

11. When determining the drawing power for large borrowers to ascertain whether an account has temporary deficiencies, the stock statements relied upon by the banks should not be older than:

- (A) One month
- (B) Three months
- (C) Six months
- (D) Twelve months

Oct/Nov 2010

12. Consider the following statements regarding non-performing asset criteria:

- I. A term loan becomes NPA when interest or installment remains overdue for more than 90 days.
- II. An OD/CC account becomes NPA when the account remains 'out of order'.
- III. Bills purchased and discounted become NPA if the bill remains overdue for more than 90 days.
- IV. The amount of liquidity facility in a securitisation transaction becomes NPA if it remains outstanding for more than 30 days.

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, III, and IV
- (D) I, II, III, and IV

May/June 2007

13. Takeout finance is an arrangement primarily designed for which of the following contexts?

- (A) Short-term working capital funding for Micro, Small and Medium Enterprises.
- (B) Funding of long-term infrastructure projects.
- (C) Extending retail credit card facilities.
- (D) Providing post-shipment credit to exporters.

simultaneously?

- (A) The bank must transfer the funded interest to an 'other reserves' account.
- (B) The bank must immediately upgrade the account to a standard asset.
- (C) The bank must reverse the funded interest in the subsequent quarter.
- (D) The bank must make a provision for an equal amount simultaneously.

May/June 2020

37. Match the Likely Loss/EBID (%) for unhedged foreign currency exposures in List I with the incremental provisioning requirement in List II. List I: (Likely Loss / EBID)
- P. Upto 15 per cent
 - Q. More than 15 per cent and upto 30 per cent
 - R. More than 30 per cent and upto 50 per cent
 - S. More than 50 per cent and upto 75 per cent
- List II: (Incremental Provisioning)
- 1. 20 bps
 - 2. 0
 - 3. 60 bps
 - 4. 40 bps
 - (A) P-2, Q-1, R-4, S-3
 - (B) P-1, Q-4, R-2, S-3
 - (C) P-3, Q-1, R-4, S-2
 - (D) P-4, Q-2, R-3, S-1

Oct/Nov 2005

38. Read the following scenario and answer the question:
An infrastructure loan account with an outstanding balance of ₹100 Crores is classified as sub-standard. It is identified as an unsecured exposure ab-initio. The bank has an appropriate mechanism to escrow the cash flows and holds a clear legal first claim on them.
 What is the precise provisioning requirement for this account?
- (A) 15 per cent
 - (B) 20 per cent
 - (C) 25 per cent
 - (D) 100 per cent

May/June 2017

39. Which of the following pairs correctly matches the asset category with its defining characteristic?
- (A) Doubtful Asset - An asset where loss has been identified by the bank but not written off.

- (B) Substandard Asset - An asset which has remained NPA for a period less than or equal to 12 months.
- (C) Loss Asset - An asset that has remained in the substandard category for exactly 6 months.
- (D) Standard Asset - An asset where the realisable value of security is less than 10 per cent of the outstanding.

Oct/Nov 2024

40. Read the following scenario and answer the question:
A borrower's principal payment on a term loan was due on 1st March. As of 25th April of the same year, the payment has not been made, and the account shows signs of incipient stress. Assuming no leap year, the days overdue fall between 31 and 60 days.
 How should the lender classify this account for reporting purposes?
- (A) SMA-0
 - (B) SMA-1
 - (C) SMA-2
 - (D) Sub-standard

May/June 2010

41. Which of the following pairs regarding general provisioning rates for standard assets is incorrect?
- (A) Advances to Medium Enterprises : 1.00 per cent
 - (B) Advances to Commercial Real Estate - Residential Housing Sector (CRE - RH) : 0.75 per cent
 - (C) Farm Credit to Small and Micro Enterprises (SMEs) sectors : 0.25 per cent
 - (D) All other loans and advances not specifically categorized : 0.40 per cent

Oct/Nov 2011

42. An asset, including a leased asset, becomes a non-performing asset (NPA) in the case of a term loan when:
- (A) The outstanding balance remains continuously in excess of the sanctioned limit for more than 90 days.
 - (B) Interest and/or installment of principal remain overdue for a period of more than 90 days.
 - (C) The account shows temporary deficiencies such as non-availability of adequate drawing

Central Government may be treated as NPA only when the Government repudiates its guarantee when invoked.

- (C) The exemption from classification of Central Government guaranteed advances as NPA is not for the purpose of recognition of income.
- (D) Reversal of income rules apply to government guaranteed accounts that become NPA.

Oct/Nov 2018

20. Consider the following concerning provisioning for standard assets and unhedged foreign currency exposures:

- I. The provisions on standard assets are not to be reckoned for arriving at net NPAs.
- II. Standard asset provisions are shown separately as 'Contingent Provisions against Standard Assets'.
- III. The Medium Enterprises sector attracts 0.40% standard asset provisioning.
- IV. A likely loss of more than 75 per cent on unhedged foreign currency exposure requires an incremental provisioning of 80 bps.
- V. A likely loss of up to 15 per cent on unhedged foreign currency exposure requires an incremental provisioning of 20 bps.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) I, II, IV, and V
- (C) II, III, IV, and V
- (D) I, III, IV, and V

May/June 2016

21. Which of the following statements regarding provisioning norms for all cases of fraud is incorrect?

- (A) Banks should normally provide for the entire amount due immediately upon a fraud being detected.
- (B) Banks have the option to make the provisions over a period not exceeding four quarters.
- (C) If provisioning over multiple quarters spans more than one financial year, banks should debit 'Balance in Profit and Loss Account' for the un-provided amount at year-end.
- (D) Banks cannot adjust any financial collateral eligible under Basel III Capital Regulations while computing the provisioning requirement.

Oct/Nov 2009

NODIA 2.

The following question consists of two statements, an Assertion (A) and a Reason (R). Select the correct answer using the options provided below:

Assertion (A): Income from non-performing assets is not recognised on an accrual basis but is booked as income only when actually received.

Reason (R): The policy of income recognition has to be objective and based on the record of recovery, aligning with international practices.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2022

23. Advances against certain securities are exempted from being treated as NPAs provided adequate margin is available. Which of the following is NOT covered by this exemption?

- (A) Term Deposits
- (B) Gold ornaments
- (C) National Savings Certificates (NSCs)
- (D) Kisan Vikas Patras (KVPs)

Oct/Nov 2020

24. The following question consists of two statements, an Assertion (A) and a Reason (R). Select the correct answer using the options provided below:

Assertion (A): Where there is severe erosion in the value of security such that its realisable value is less than 50 per cent of the value assessed, the account must still sequentially pass through the substandard classification stage before becoming doubtful.

Reason (R): It is prudent that serious credit impairments bypass the standard staging and be straightaway classified as doubtful or loss assets to reflect true financial health.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2022

50. In banking practices regarding non-performing assets, how is income typically recognized if not on an accrual basis?
- (A) It is recognised based on the projected future cash flows of the borrower.
 - (B) It is capitalized and added to the principal outstanding balance.
 - (C) It is booked as income only when it is actually received.
 - (D) It is recognised proportionately over the remaining tenure of the loan.

May/June 2005

51. Which of the following statements about the Insolvency and Bankruptcy Code (IBC) are correct?
- I. Bankrupt individuals are allowed to contest elections if they have secured creditors' approval.
 - II. Workers' salaries for up to 24 months will get first priority in case of liquidation, ahead of secured creditors.
 - III. Money due to employees from Provident Fund and gratuity funds will not be included in the estate of the bankrupt company.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2010

52. What is the core principle governing the asset classification of multiple facilities granted to a single borrower?
- (A) Each facility is classified independently based on its specific record of recovery and payment history.
 - (B) Asset classification is strictly facility-wise, regardless of the borrower's overall financial health.
 - (C) Classification is based on the highest value facility in the borrower's portfolio at the end of the year.
 - (D) All facilities granted to a borrower are treated as NPA if any one facility becomes a

problem credit.

May/June 2021

53. Assess the following statements regarding accounts with temporary deficiencies:
- I. An advance should be classified as NPA solely due to temporary non-availability of adequate drawing power.
 - II. Drawing power is required to be arrived at based on the stock statement which is current.
 - III. Stock statements relied upon by banks for drawing power should not be older than three months.
 - IV. An account will become NPA if irregular drawings are permitted for a continuous period of 90 days.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
 - (B) II, III, and IV
 - (C) I, III, and IV
 - (D) I, II, III, and IV

Oct/Nov 2006

54. Which of the following statements accurately describes the reversal of income for an advance that becomes NPA?
- (A) Interest accrued and credited to income account in the previous year is retained even if only partially realised.
 - (B) Fees and commission accrued in the current period continue to be recognised on an accrual basis until recovery.
 - (C) Interest accrued and credited in the previous year must be reversed or provided for if not realised.
 - (D) Government guaranteed accounts are exempt from the reversal of income provisions despite turning into NPAs.

May/June 2012

55. Examine the following statements about the Concept of Bad Bank (NARCL and IDRCL):
- I. The NARCL will acquire stressed assets from commercial banks in different phases.
 - II. IDRCL acts as the entity that tries to sell the stressed assets in the market.
 - III. NARCL will pay 100% of the agreed price in cash upfront to the commercial banks.
 - IV. A government guarantee of a specific amount has been approved to support the structure.

for 90 days continuously, the account will become NPA.

- (D) The drawings are regularized by imposing a penal interest rate, keeping the account as a standard asset.

May/June 2006

31. What happens if regular or ad hoc credit limits are not reviewed or renewed within 180 days from the due date or date of ad hoc sanction?
- (A) The limits are automatically renewed for a further period of 90 days.
- (B) The account will be treated as an NPA.
- (C) The account is classified as a doubtful asset immediately.
- (D) The borrower is required to furnish additional collateral to maintain the standard status.

Oct/Nov 2008

32. Read the following scenario and answer the question:
Bank X has granted a term loan and discounted bills under a Letter of Credit (LC) for Borrower Y. The term loan turns NPA due to non-payment. The bills discounted under the LC have not yet reached their due dates.
 How should the bills discounted be classified?
- (A) They remain as standard assets until the issuing bank formally rejects payment or the borrower defaults on other facilities.
- (B) They are automatically classified as NPA immediately with effect from the date the term loan was classified as NPA.
- (C) They are treated as standard assets as long as the borrower continues paying interest on the LC commission and fees.
- (D) They are only NPA if the issuing bank fails to pay on the due date and the borrower does not make good the amount.

May/June 2024

33. Consider the following stages and timelines for concluding the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC):
- I. Base period required for completion of CIRP.
- II. Extended maximum time including any extension and legal proceedings.
- III. Grace period extension if majority creditors agree.

Arrange the stages in chronological order from shortest to longest duration:

- (A) I, III, II
- (B) III, I, II
- (C) I, II, III
- (D) II, I, III

Oct/Nov 2021

34. Read the following scenario and answer the question:

A commercial bank detects a fraud in a deposit account involving an amount of ₹4 Crores during the first quarter of the financial year. The bank decides to spread the provisioning over four quarters.

In the third quarter of the same financial year, how much total cumulative provision should the bank have made for this fraud?

- (A) ₹1 Crore
- (B) ₹2 Crores
- (C) ₹3 Crores
- (D) ₹4 Crores

May/June 2013

35. Match the period for which an advance has remained in the 'doubtful' category in List I with the required provisioning requirement for the secured portion in List II.

List I: (Doubtful Category Duration)

- P. Up to one year
- Q. One to three years
- R. More than three years
- S. Unsecured portion of doubtful asset

List II: (Provisioning Requirement)

1. 40%
2. 100%
3. 25%
4. 100% (unsecured)
- (A) P-2, Q-3, R-1, S-4
- (B) P-1, Q-4, R-2, S-3
- (C) P-3, Q-1, R-2, S-4
- (D) P-4, Q-2, R-3, S-1

Oct/Nov 2015

36. Read the following scenario and answer the question:

A bank has funded the overdue interest of a project loan under implementation, which is currently classified as an NPA. The bank recognises this funded interest as income for the current financial year.

What regulatory action must the bank take

repaid by the period's end.

- (C) The account can be upgraded immediately upon the first payment under the resolution plan terms.
- (D) If arrears of interest and principal are paid by the borrower in NPA accounts, they may be classified as 'standard'.

May/June 2011

61. Evaluate the following statements about the Insolvency and Bankruptcy Code (IBC):
- I. The IBC shifts the insolvency regime from 'creditor-in-control' to 'debtor-in-possession'.
 - II. Operational debt should be free from any pre-existing dispute to trigger CIRP.
 - III. A moratorium prohibits the institution and continuation of any proceedings against the corporate debtor.
 - IV. The moratorium does not protect the key managerial personnel responsible for the insolvency.
 - V. The IBC bars certain individuals, including related parties of the corporate debtor, from participating in the Committee of Creditors (CoC).
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV
(B) II, III, IV, and V
(C) I, III, IV, and V
(D) I, II, IV, and V

Oct/Nov 2012

62. Banks are required to report credit information on all borrowers having an aggregate exposure of ₹ 50 million and above to the Central Repository of Information on Large Credits (CRILC). Which of the following exposures is NOT exempt from such reporting?
- (A) Interbank exposures
(B) Exposures to NABARD
(C) Loans to Corporate entities with aggregate exposure of ₹50 million and above
(D) Crop loans

May/June 2015

63. The following question consists of two statements, an Assertion (A) and a Reason (R). Select the correct answer using the options provided below:
- Assertion (A): If arrears of interest and principal are paid by the borrower in a loan

account classified as NPA, it can immediately be upgraded to a 'standard' account.

Reason (R): Upgradation of MSME accounts requires demonstration of satisfactory performance during a specified period of one year.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2013

64. The guidelines prescribed for transactions involving the transfer of assets through direct assignment of cash flows and underlying securities do NOT apply to which of the following?
- (A) Transfer of a pool of retail loans
(B) Transfer of a pool of non-retail loans
(C) Situations where the originating bank maintains a consolidated account for Minimum Retention Requirement (MRR)
(D) Inter-bank participations

May/June 2008

65. The following question consists of two statements, an Assertion (A) and a Reason (R). Select the correct answer using the options provided below:
- Assertion (A): If a bank extends both a term loan and a cash credit facility to a single borrower, and only the term loan defaults, both facilities must be classified as NPA.
- Reason (R): Asset classification must be borrower-wise and not facility-wise, because it is difficult to envisage a situation where only one facility becomes a problem credit and not the others.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
(C) Assertion (A) is true, but Reason (R) is false.
(D) Assertion (A) is false, but Reason (R) is true.

between 31-60 days

2. Outstanding balance remains continuously in excess of the sanctioned limit for 31-60 days
 3. Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
 4. Principal or interest payment overdue between 61-90 days
- (A) P-3, Q-2, R-4, S-1
(B) P-1, Q-4, R-2, S-3
(C) P-3, Q-1, R-4, S-2
(D) P-4, Q-2, R-3, S-1

May/June 2023

77. Read the following scenario and answer the question:

An advance with an outstanding balance of ₹50 Lakhs has been in the doubtful category for two years. The realisable value of the tangible security properly discharged to the bank is ₹30 Lakhs.

What is the total provisioning requirement for this asset?

- (A) ₹30 Lakhs (100% of secured) + ₹20 Lakhs (100% of unsecured) = ₹50 Lakhs.
(B) ₹12 Lakhs (40% of secured) + ₹20 Lakhs (100% of unsecured) = ₹32 Lakhs.
(C) ₹7.5 Lakhs (25% of secured) + ₹20 Lakhs (100% of unsecured) = ₹27.5 Lakhs.
(D) ₹15 Lakhs (50% of secured) + ₹10 Lakhs (50% of unsecured) = ₹25 Lakhs.

Oct/Nov 2018

78. Match the asset classification in List I with the standard provisioning percentage for the secured portion in List II.

List I: (Asset Classification)

- P. Sub-standard (secured)
Q. Doubtful I (secured portion)
R. Doubtful II (secured portion)
S. Doubtful III (secured portion)

List II: (Provisioning %)

1. 40
2. 100
3. 15
4. 25

- (A) P-3, Q-4, R-1, S-2
(B) P-3, Q-4, R-2, S-1
(C) P-1, Q-2, R-4, S-3
(D) P-4, Q-1, R-3, S-2

May/June 2016

79. Read the following scenario and answer the question:

A corporate client has an unhedged foreign currency exposure. During times of high currency volatility, the bank calculates the likely loss/EBID as 45 per cent. The account is currently classified as a standard asset.

What incremental provisioning requirement applies to this credit exposure?

- (A) 0 bps
(B) 20 bps
(C) 40 bps
(D) 60 bps

Oct/Nov 2025

80. Which of the following pairs accurately reflects the required treatment for temporary deficiencies in loan accounts?

- (A) Outstanding balance exceeding the limit temporarily - Automatic reclassification to NPA within 30 days.
(B) Regular/ad hoc credit limits not renewed within 90 days - Treated as Loss Asset.
(C) Non-availability of financial statements - Exemption from NPA classification indefinitely.
(D) Stock statement older than three months - Drawing power calculation is deemed irregular.

- (B) The account may be upgraded to standard because it showed satisfactory performance for one year.
- (C) The account can only be upgraded if the aggregate exposure of the lenders is significantly more than ₹25 crores.
- (D) The account requires a mandatory provision of 25% before it can be upgraded to a standard asset status.

Oct/Nov 2015

72. Consider the following Special Mention Account (SMA) sub-categories for a non-revolving credit facility:

- I. SMA-1
- II. SMA-0
- III. SMA-2

Arrange the sub-categories in the chronological order of their overdue duration:

- (A) I, II, III
- (B) II, I, III
- (C) III, I, II
- (D) II, III, I

May/June 2020

73. Read the following scenario and answer the question:

In a consortium lending arrangement led by Bank A, Bank B participates with a 20% share. Bank A receives the remittance from the borrower but does not part with Bank B's share due to internal discrepancies. In the books of Bank B, the account is not serviced for over 90 days.

What is the appropriate asset classification action for Bank B?

- (A) Bank B must classify the account as NPA because it has not been serviced in its own books.
- (B) Bank B can retain the standard classification based on Bank A's verbal assurance.
- (C) Bank B must write off the 20% share as a loss asset immediately.
- (D) Bank B should downgrade the account only after conducting a joint inspection with Bank A.

Oct/Nov 2009

74. Match the standard asset categories in List I with their respective general provisioning rates in List II.

List I: (Standard Asset Category)

- P. Farm Credit to agricultural activities

- Q. Advances to Commercial Real Estate (CRE) Sector

- R. Housing loans extended at teaser rates

- S. Advances to Medium Enterprises

List II: (Provisioning Rate)

- 1. 1.00 per cent
- 2. 0.25 per cent
- 3. 0.40 per cent
- 4. 2.00 per cent

- (A) P-2, Q-1, R-4, S-3

- (B) P-1, Q-4, R-2, S-3

- (C) P-3, Q-1, R-4, S-2

- (D) P-4, Q-2, R-3, S-1

May/June 2017

75. Read the following scenario and answer the question:

A commercial bank provides a credit facility to a Primary Agricultural Credit Society (PACS) under an on-lending arrangement. The PACS sanctions two separate credit facilities to a member borrower. One facility for short duration crops defaults and is overdue for two crop seasons. The other facility is performing well. The commercial bank has also given a direct loan to this same member outside the on-lending arrangement.

What happens to the classification of the direct loan?

- (A) The direct loan becomes NPA if any credit facility granted to the borrower by the PACS is classified as NPA.
- (B) The direct loan remains a standard asset because it is outside the on-lending arrangement and is serviced regularly.
- (C) The direct loan must be restructured or reviewed by the bank's credit committee before any classification is applied.
- (D) The direct loan becomes a doubtful asset automatically due to cross-default clauses included in the loan agreement.

Oct/Nov 2005

76. Match the SMA sub-categories in List I with their respective basis for classification in List II for resolving incipient stress.

List I: (SMA Sub-category)

- P. SMA-0

- Q. SMA-1 (Revolving facilities)

- R. SMA-2 (Non-revolving facilities)

- S. SMA-1 (Non-revolving facilities)

List II: (Basis for Classification)

- 1. Principal or interest payment overdue

- 27.** (A) They are treated as a non-performing asset if they remain unpaid for 90 days or more. Overdue receivables that represent the positive mark-to-market value of a derivative contract must be handled according to specific asset classification rules. If these receivables remain unpaid for ninety days or more from the specified due date, they are treated as a non-performing asset. This ensures that market-related credit risks are properly identified and provisioned for in the bank's records.
- 28.** (C) It is an NPA, because sugarcane is long duration, and the loan becomes NPA if the installment remains overdue for one season. Agricultural loans are classified based on the duration of the crop season. Sugarcane is considered a long duration crop because its harvest cycle exceeds one year. For such crops, the loan is treated as a non-performing asset if the installment of principal or interest remains overdue for one full crop season. Therefore, an overdue period of one and a half seasons qualifies.
- 29.** (B) Thirty days from the date of default
Upon the occurrence of a default by any borrower, lenders are required to undertake a prima facie review of the account. This initial assessment, known as the review period, lasts for thirty days. During this timeframe, lenders evaluate the borrower's financial position and decide on the appropriate resolution strategy, which may include restructuring or taking legal action for recovery.
- 30.** (C) The drawings are irregular; if permitted for 90 days continuously, the account will become NPA. Drawing power must be based on current stock statements, which should not be more than three months old. If a borrower fails to provide an updated statement, the drawings are considered irregular. If such irregular drawings are permitted to continue for a period of ninety days, the account must be classified as a non-performing asset due to the lack of updated collateral valuation.
- 31.** (B) The account will be treated as an NPA.
Banks must periodically review or renew regular and ad hoc credit limits to assess the borrower's ongoing creditworthiness. If these limits are not renewed within one hundred and eighty days from the due date or the date of the ad hoc sanction, the account is classified as a non-performing asset. This rule prevents the perpetual extension of credit without formal reassessment.
- 32.** (D) They are only NPA if the issuing bank fails to pay on the due date and the borrower does not make good the amount.
While asset classification is generally borrower-wise, bills discounted under a Letter of Credit are treated differently. Even if a borrower's term loan is non-performing, bills discounted under an LC remain standard until they reach their due date. They only become non-performing if the issuing bank fails to pay and the borrower does not reimburse the amount to the bank.
- 33.** (B) III, I, II
The Corporate Insolvency Resolution Process follows a structured timeline under the Insolvency and Bankruptcy Code. The process begins with a base period of one hundred and eighty days for completion. Creditors may agree to a shorter extension or grace period during the proceedings. However, the maximum allowable time, including all extensions and legal processes, is capped at three hundred and thirty days.
- 34.** (C) ₹3 Crores
When a bank opts to spread the provisioning for a detected fraud over four quarters, it must do so proportionately. For a fraud amounting to four crore rupees, the bank should provide one crore rupee each quarter. By the end of the third quarter, the cumulative provision made in the financial statements should reach seventy-five percent, totaling three crore rupees.
- 35.** (C) P-3, Q-1, R-2, S-4
Provisioning for doubtful assets depends on the duration for which the asset has remained in the doubtful category. Assets in this category for up to one year require a twenty-five percent provision on the secured portion. This increases to forty percent for one to three years and reaches one hundred percent after three years. Unsecured portions of any doubtful asset always require full provisioning.
- 36.** (D) The bank must make a provision for an equal amount simultaneously.
If a bank converts overdue interest on a non-performing asset into a new credit facility, such as

ANSWERS

1. (A) ₹15 Crores
The operational structure of the National Asset Reconstruction Company Limited involves purchasing stressed assets from commercial banks through a specific payment split. Under this mechanism, the purchasing entity provides fifteen percent of the agreed price as an upfront cash payment. The remaining eighty-five percent is issued in the form of government-guaranteed security receipts to the selling bank.
2. (C) SMA-1 (revolving) : Outstanding balance remains continuously in excess of sanctioned limit for 1 - 30 days.
Special Mention Account classification identifies incipient stress in borrowal accounts. For revolving credit facilities such as cash credit or overdrafts, the SMA-one sub-category applies when the outstanding balance remains continuously in excess of the sanctioned limit or drawing power for thirty-one to sixty days. A duration of one to thirty days is designated as the SMA-zero category instead.
3. (A) The outstanding balance remains continuously in excess of the sanctioned limit or drawing power.
An account is considered out of order if the outstanding balance remains continuously in excess of the sanctioned limit or drawing power for ninety days. It also applies if there are no credits for ninety days or if credits are insufficient to cover interest debited during the same period. This classification is primarily used for revolving credit facilities like overdrafts.
4. (A) Only I
For Micro, Small, and Medium Enterprises, a loan account classified as non-performing can be upgraded to standard status upon demonstrating satisfactory performance for one year. Satisfactory performance specifically requires that no payment remains overdue for more than thirty days during this period. Therefore, requiring a sixty-day window for overdue payments does not meet the necessary regulatory criteria.
5. (D) Loss has been identified by the bank or auditors/inspectors but not yet written off wholly. A loss asset is one where the bank or internal and external auditors have identified a permanent loss, but the amount has not been written off entirely. These assets are considered uncollectible and of such little value that their continuance as bankable assets is not warranted, although there might be some salvage or recovery value remaining in them.
6. (C) Both I and II
Significant erosion in the value of security requires immediate reclassification of non-performing assets. When the realisable value of security falls below fifty percent of the value assessed by the bank, the asset is classified as doubtful. If the realisable value drops below ten percent of the outstanding amount, the asset must be straightaway classified as a loss asset.
7. (B) Less than ₹25 crores
Regulatory guidelines allow for the upgradation of Micro, Small, and Medium Enterprise accounts that have been restructured due to financial stress. This specific provision applies to accounts where the aggregate exposure of all lending institutions is less than twenty-five crore rupees. Such accounts must demonstrate satisfactory performance over a specified monitoring period to be returned to standard status.
8. (A) I and II only
Financial difficulty is indicated by several factors including defaults on debt obligations and the delisting of a borrower's securities. Other signs include significant financial losses or concerns about the borrower's ability to continue as a going concern. Since non-performing status is a direct result of repayment failure, it is naturally included as a primary indicator of financial distress.
9. (D) 1.00 per cent
Banks are required to maintain general provisions for standard assets to build a buffer against potential future losses. For advances made to the

Oct/Nov 2017

66. The Insolvency and Bankruptcy Code (IBC) sets out three classes of persons who can trigger the corporate insolvency resolution process (CIRP). Which of the following is NOT one of those classes?
- (A) Financial creditors
 - (B) Operational creditors
 - (C) Insolvency Professionals
 - (D) Corporate debtors

May/June 2006

67. Read the following scenario and answer the question:
A manufacturing firm holds an Overdraft (OD) facility with a sanctioned limit of ₹50 lakhs. Over the last 95 days, the outstanding balance has continuously stood at ₹52 lakhs. No credits have been deposited during this period.
 How should the bank classify this account and why?
- (A) As an NPA, because the account has remained 'out of order' for more than 90 days.
 - (B) As a standard asset, as OD facilities cannot be classified as NPA until the facility tenure expires or matures.
 - (C) As a doubtful asset, as any excess drawing beyond the sanctioned limit triggers an immediate downgrade in classification.
 - (D) As a substandard asset, because the borrower failed to renew the ad hoc limits within the required 180-day window.

Oct/Nov 2008

68. When the amount of interest dues is converted into quoted equity, how can the interest income be recognised?
- (A) It can be recognised at the book value of the equity as of the conversion date regardless of market price.
 - (B) It must be deferred until the equity shares are sold in the open market and cash is actually received.
 - (C) It is recognised based on a fixed percentage prescribed by the regulator based on the age of the NPA.
 - (D) It is recognised at market value on conversion date, not exceeding the interest amount converted.

May/June 2024

69. Read the following scenario and answer the question:
A corporate borrower's term loan became an NPA on 31st March of the previous financial year. By 30th September of the current year, the borrower makes a partial payment covering a portion of the overdue interest. There is no clear agreement between the bank and the borrower regarding the appropriation of recoveries.
 What principle should the bank follow to appropriate this recovery?
- (A) The bank must first adjust the recovery against the principal amount exclusively to reduce overall debt.
 - (B) The bank must seek express approval from the regulator before appropriating any partial recovery from the borrower.
 - (C) The bank should keep the amount in a suspense account until the full outstanding interest is finally recovered.
 - (D) The bank should adopt a consistent accounting principle to exercise the right of appropriation of recoveries.

Oct/Nov 2021

70. For the purpose of agricultural advances, how are "long duration" crops defined?
- (A) Crops with a crop season longer than six months.
 - (B) Crops with a crop season longer than one year.
 - (C) Crops requiring multiple harvesting cycles within a single year.
 - (D) Crops determined exclusively by the individual lending bank's board.

May/June 2013

71. Read the following scenario and answer the question:
A MSME entity's loan account was restructured and classified as NPA. Under the restructuring package, the entity makes its first payment of interest on 1st April. For the next 14 months, no payment remains overdue for more than 30 days, and the outstanding balance remains below the sanctioned limit.
 Based on the conditions for upgrade, how should the bank handle this account?
- (A) The account must remain as NPA until the entire principal amount has been repaid by the entity.

certain conditions. For non-retail exposures, purchasing banks must apply asset classification and provisioning based on individual obligors. These guidelines are specific to loan transfers and do not apply to inter-bank participation or bonds.

19. (A) State Government guaranteed advances do not attract asset classification and provisioning norms under any circumstances.
Advances guaranteed by the Central Government are only treated as non-performing when the government repudiates the guarantee upon invocation. This exemption does not apply to the recognition of income, which must still follow cash-basis rules. Importantly, advances guaranteed by State Governments do not enjoy this exemption and are subject to normal asset classification and provisioning norms immediately upon default.
20. (A) I, II, III, and IV
Provisions for standard assets are kept as a separate buffer and are not deducted when calculating net non-performing assets. These are recorded as contingent provisions in the financial statements. Specific sectors like medium enterprises attract a zero-point-four percent provision. Additionally, incremental provisions are required for borrowers with unhedged foreign currency exposure depending on the potential loss relative to earnings.
21. (D) Banks cannot adjust any financial collateral eligible under Basel III Capital Regulations while computing the provisioning requirement.
When a fraud is detected, banks are required to provide for the entire outstanding amount. While this can be spread over four quarters, any unprovided amount at the end of the financial year must be debited from the profit and loss account. Importantly, banks are permitted to adjust the value of eligible financial collateral when determining the final provisioning amount.
22. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Income from non-performing assets is recognized only upon actual receipt rather than on an accrual basis. This policy ensures that the bank's income recognition is objective and based on the actual

record of recovery. Aligning with international accounting practices, this approach prevents the inflation of profits with unrealised income from loans that are not being serviced by borrowers.

23. (B) Gold ornaments
Certain advances are exempt from being classified as non-performing assets if they are backed by securities with adequate margins. This exemption applies specifically to credit facilities secured by term deposits, National Savings Certificates, Kisan Vikas Patras, and life insurance policies. However, advances against gold ornaments do not receive this regulatory exemption and must follow standard asset classification and delinquency norms.
24. (D) Assertion (A) is false, but Reason (R) is true.
Assets with severe credit impairment do not need to follow a sequential classification process. If the realisable value of the security is less than fifty percent of the assessed value, the account should be straightaway classified as a doubtful asset. This bypasses the substandard stage to ensure that the bank's financial health and the risk of loss are accurately represented.
25. (A) A borrower's outstanding securities have been listed on a new international exchange.
Indicators of financial difficulty include defaults, delinquency in payments, and classification of existing exposures as stressed. These signs suggest that a borrower may struggle to meet repayment obligations. In contrast, the listing of a borrower's securities on a new international exchange is generally a sign of growth or expansion rather than a non-exhaustive indicator of financial distress or insolvency.
26. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
The Provisioning Coverage Ratio is a measure of the cushion a bank has against potential losses from its non-performing assets. Maintaining a ratio of at least seventy percent serves as a macro-prudential buffer. This buffer, built during profitable periods, enhances financial stability by providing the necessary resources to absorb losses during economic downturns when loan defaults typically increase significantly.

Commercial Real Estate sector, the prescribed provisioning rate is one percent of the total outstanding amount. This rate is higher than the general category to account for the increased cyclical risks associated with real estate.

10. (D) I, II, and III

Upon detection of fraud, banks are required to provide for the entire amount due. Regulatory flexibility allows banks to spread this provisioning over a period not exceeding four consecutive quarters. Furthermore, banks are permitted to adjust the value of eligible financial collateral, as defined under capital regulations, when calculating the total provisioning requirement for the fraudulent exposure.

11. (B) Three months

Drawing power for large borrowers is determined based on current stock statements submitted to the bank. To ensure that the credit extended is backed by actual assets, these stock statements should not be older than three months. Statements exceeding this timeframe are considered outdated, and the account may be classified as having temporary deficiencies or irregularities.

12. (A) I, II, and III

Non-performing assets are categorized based on specific delinquency periods for different types of credit. Term loans and bills discounted are classified as such if payments are overdue for more than ninety days. Similarly, overdrafts and cash credit accounts are classified when they remain out of order. However, liquidity facilities in securitisation also follow the ninety-day delinquency rule.

13. (B) Funding of long-term infrastructure projects. Takeout finance is a funding mechanism primarily used for long-term infrastructure projects to manage maturity mismatches. Under this arrangement, an initial lending institution provides short to medium-term financing, which is subsequently taken over by a different institution for the remaining project duration. This helps commercial banks avoid locking up funds in long-gestation projects beyond their typical liquidity horizons.

14. (A) I, II, and III

For projects under implementation, banks may recognise income on an accrual basis only for accounts classified as standard. Once an account becomes substandard, income must be recognised on a cash basis. If interest on a non-performing asset is converted into funded interest, an equivalent provision is required. Income from converted equity is restricted to the original interest amount.

15. (D) It may be taken to income account on the due date if adequate margin is available.

Interest on advances granted against securities like term deposits, National Savings Certificates, Kisan Vikas Patras, and life insurance policies may be taken to the income account on the due date. This is permissible provided there is adequate margin available in the account. These facilities are exempt from standard non-performing asset classification norms regarding interest income recognition.

16. (A) I, II, and III

Credit card accounts are classified as non-performing if the minimum amount due is not paid within ninety days from the payment due date. Banks provide monthly statements with a clear due date and an option for partial payment. This classification method is used for both internal accounting and mandatory reporting to credit information companies to ensure transparency in credit history.

17. (B) Banks may recognise income on an accrual basis in respect of projects classified as 'standard'. Income recognition for projects under implementation follows strict prudential norms. Banks are permitted to recognise interest income on an accrual basis for project loans that are classified as standard assets. For any asset classified as substandard or lower, income must only be recognized upon actual receipt to ensure the bank's financial statements accurately reflect its recovered earnings.

18. (A) I, II, III, and V

Transactions involving direct assignment of cash flows require originators to maintain borrower-wise accounts for non-retail loans, though consolidated accounts and pool-level asset classification are permitted for retail pools under

funded interest, it may recognize this as income. However, to maintain financial prudence, the bank must simultaneously create a provision for an amount equal to the income recognized. This ensures that the bank does not artificially inflate its earnings without actual cash recovery.

37. (A) P-2, Q-1, R-4, S-3

Incremental provisioning for unhedged foreign currency exposures is determined by the potential loss as a percentage of the borrower's earnings. Exposure with a likely loss of up to fifteen percent requires no incremental provision. As the risk increases, the rates move to twenty, forty, sixty, and eighty basis points. This tiered approach ensures that banks hold more capital against higher currency risks.

38. (B) 20 per cent

For infrastructure projects classified as substandard, specific provisioning rules apply to unsecured exposures. If the bank has a functional escrow mechanism and a clear legal first claim on the cash flows, the provisioning requirement is set at twenty percent. This rate is a concession compared to the twenty-five percent required for other unsecured substandard assets, reflecting the structured nature of infrastructure financing.

39. (B) Substandard Asset - An asset which has remained NPA for a period less than or equal to 12 months.

Asset classification is based on the period for which an asset has remained non-performing. A substandard asset is specifically defined as one that has been classified as non-performing for a period less than or equal to twelve months. Once an asset exceeds this twelve-month threshold in the substandard category, it is further downgraded to the doubtful category based on risk.

40. (B) SMA-1

Special Mention Account reporting helps lenders identify early signs of stress before an account becomes non-performing. For non-revolving facilities, the SMA-one sub-category is used when the principal or interest payment is overdue for more than thirty days but up to sixty days. Since the payment in this scenario is fifty-five days overdue, it falls squarely within this classification.

41. (A) Advances to Medium Enterprises : 1.00 per cent

Banks must maintain general provisions for standard assets across different sectors. The rate for the Commercial Real Estate Residential Housing sector is zero-point-seven-five percent, while farm credit and small enterprises attract a zero-point-two-five percent rate. However, advances to medium enterprises are subject to a zero-point-four percent provisioning rate, making the one percent figure incorrect for this specific category.

42. (B) Interest and/or installment of principal remain overdue for a period of more than 90 days. A term loan is classified as a non-performing asset when the interest or the installment of the principal remains overdue for a period exceeding ninety days. This clear time-bound criterion is used by banks to ensure uniformity in identifying assets that have ceased to generate regular income. It is a fundamental part of the prudential norms governing the Indian banking system.

43. (A) Only I

Agricultural advances follow distinct non-performing asset criteria based on crop cycles rather than fixed days. For short duration crops, the loan becomes non-performing if installments or interest remain overdue for two crop seasons. The duration and timing of these seasons are determined by the State Level Bankers' Committee in each state rather than being applied on a uniform national basis.

44. (C) Has remained in the substandard category for a period of 12 months.

The classification of a non-performing asset progresses based on the duration of the default. An asset is specifically categorized as doubtful if it has remained in the substandard category for a period of twelve months. This classification indicates a higher risk of loss compared to substandard assets and requires banks to maintain higher provisioning to cover potential credit defaults.

45. (C) Both I and II

Overdue receivables from derivative contracts are classified as non-performing assets if they remain unpaid for ninety days or more. However, if the overdues arise specifically from forward contracts

or plain vanilla swaps, the non-performing status of these derivative receivables does not trigger a mandatory downgrade of the borrower's other funded credit facilities. This provides a specific exception for simple hedging instruments.

46. (B) August 1991

The high-level committee on the financial system, which significantly influenced Indian banking reforms and non-performing asset norms, was appointed in August 1991. Chaired by M. Narasimham, the committee's recommendations led to the introduction of international prudential standards for income recognition, asset classification, and provisioning, aiming to improve the transparency and health of the Indian banking sector.

47. (A) I and II only

When an advance is classified as non-performing, any interest that was accrued and credited to the income account in the previous year but remains unrealised must be reversed. Additionally, fees and commissions on such assets must cease to accrue for the current period. These rules ensure that the bank's profit is not inflated by income that is unlikely to be collected.

48. (D) 100 per cent

The provisioning requirement for non-performing assets varies based on the availability of security and the age of the default. For any asset classified as doubtful, the portion that is not covered by the realisable value of tangible security is considered unsecured. Regulatory norms mandate that banks must provide one hundred percent for this unsecured portion to fully cover the potential loss.

49. (B) II and III only

In post-shipment credit, the portion covered by export-import guarantees is not treated as non-performing. In takeout finance arrangements, the institution taking over the loan must classify the account as non-performing from the original date of default. Furthermore, income on non-performing assets under such arrangements must be recognised on a cash basis rather than an accrual basis to ensure prudence.

50. (C) It is booked as income only when it is actually received.

The primary principle for income recognition on non-performing assets is the record of recovery. Unlike standard assets where income is recognised on an accrual basis, income from non-performing assets is only booked when it is actually received in cash. This ensures that the bank's financial statements are transparent and do not include unrealised earnings from loans that are in default.

51. (B) II and III only

The Insolvency and Bankruptcy Code provides a clear hierarchy for the distribution of assets during liquidation. Workers' salaries for the twenty-four months preceding liquidation are given top priority, alongside secured creditors. Additionally, assets such as employee provident funds and gratuity funds are specifically excluded from the bankrupt company's estate, ensuring these employee benefits are protected from the claims of other creditors.

52. (D) All facilities granted to a borrower are treated as NPA if any one facility becomes a problem credit.

Asset classification in banking is strictly borrower-wise rather than facility-wise. This means that if any one credit facility granted to a borrower is classified as a non-performing asset, all other facilities extended to that same borrower must also be classified as non-performing. This principle reflects the view that a default in one area indicates a general decline in the borrower's creditworthiness.

53. (B) II, III, and IV

An account is not classified as non-performing solely due to temporary deficiencies like the non-availability of stock statements. However, for large borrowers, drawing power must be based on stock reports that are no more than three months old. If drawings remain irregular due to outdated statements or other factors for a continuous period of ninety days, the account is then classified as non-performing.

- 54.** (C) Interest accrued and credited in the previous year must be reversed or provided for if not realised.

Prudential norms require that when a loan account turns into a non-performing asset, any interest that was accrued and credited to the income account in the previous financial year must be reversed if it has not been realized. This process prevents the bank from overstating its profits and ensures that the financial statements reflect the actual cash-generating capacity of the loan portfolio.

- 55.** (B) I, II, and IV

The Bad Bank structure in India comprises the National Asset Reconstruction Company Limited and the India Debt Resolution Company Limited. NARCL acquires stressed assets in phases from commercial banks using a mix of cash and security receipts. IDRCL is responsible for the market-based resolution and sale of these assets. The entire mechanism is supported by a government guarantee to ensure the viability of the security receipts.

- 56.** (A) The account becomes NPA if the minimum amount due is not paid within 90 days from the due date.

A credit card account is classified as a non-performing asset if the minimum amount due, as specified in the monthly statement, is not paid within ninety days from the payment due date. This standardized approach ensures that revolving credit defaults are identified consistently across the banking sector. The ninety-day window provides a clear threshold for reporting delinquency to credit information bureaus.

- 57.** (B) I, II, IV, and V

Generally, all facilities of a borrower are classified as non-performing if one facility defaults. However, specific exceptions exist, such as for bills discounted under Letters of Credit, which are not automatically downgraded. Furthermore, specific historical derivative overdues from the two thousand seven to two thousand eight period were exempted from triggering a cross-default classification for other funded facilities of the same borrower.

- 58.** (B) If a bank receives remittances and does not part with the share of other member banks, the account is treated as serviced in the books of the other banks.

In consortium lending, asset classification is based on the actual recovery record of each individual member bank. If a lead bank receives a repayment from the borrower but fails to distribute the proportionate share to other member banks, those banks cannot treat the account as serviced. They must classify the account as non-performing in their own books based on their actual cash receipts.

- 59.** (A) I, II, III, and IV

As per prudential norms, lenders must create additional provisions if a Resolution Plan is delayed—20% after 180 days and a total of 35% after 365 days. These provisions are over and above standard asset classification provisions and are capped at 100% of outstanding exposure. However, initiation of a Resolution Plan does not strictly require a formal default, making statement V incorrect.

- 60.** (C) The account can be upgraded immediately upon the first payment under the resolution plan terms.

Standard accounts that were classified as non-performing can be upgraded once all facilities show satisfactory performance during a specified monitoring period. For restructured accounts, this typically requires the repayment of at least ten percent of the total debt. Immediate upgradation upon the first payment is not permitted, as the borrower must prove sustained repayment capability over the designated timeframe.

- 61.** (B) II, III, IV, and V

The Insolvency and Bankruptcy Code establishes a creditor-in-control regime where a moratorium prevents legal proceedings against the debtor during resolution. Operational creditors can trigger the process only if the debt is undisputed. Key managerial personnel do not receive protection under the moratorium for their actions. Additionally, related parties are excluded from the committee of creditors to prevent conflicts of interest.

79. (C) 40 bps

Banks assess the risk of unhedged foreign currency exposures by calculating the potential loss relative to the borrower's earnings. For a calculated loss between thirty and fifty percent of the earnings before interest and depreciation, an incremental provisioning of forty basis points is required. This regulatory measure ensures that banks hold additional capital buffers against the currency volatility risks faced by their corporate clients.

80. (D) Stock statement older than three months - Drawing power calculation is deemed irregular.

In managing credit facilities, banks must distinguish between temporary administrative deficiencies and permanent credit impairment. However, drawing power must always be calculated based on current data. A stock statement that is more than three months old is considered outdated, making the drawing power calculation irregular. If this irregularity persists for ninety days, it leads to the classification of the account as a non-performing asset.

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and harvesting cycles. Long duration crops are specifically defined as those where the crop season exceeds one year. This classification is vital because it determines whether a loan becomes non-performing after one or two crop seasons of overdue payments.

71. (B) The account may be upgraded to standard because it showed satisfactory performance for one year.

A restructured MSME account can be upgraded to standard status if it demonstrates satisfactory performance for a period of one year following the first payment. Satisfactory performance means that no payment remains overdue for more than thirty days. Since the entity in this scenario met these conditions for fourteen months, the bank is permitted to return the account to a standard asset classification.

72. (B) II, I, III

Special Mention Account categories are used to track the progression of payment delays. SMA-zero is the earliest stage, representing incipient stress with no overdue period exceeding thirty days. This is followed by SMA-one, where payments are overdue between thirty-one and sixty days. Finally, SMA-two covers the period from sixty-one to ninety days, just before the account is classified as a non-performing asset.

73. (A) Bank B must classify the account as NPA because it has not been serviced in its own books. In a consortium lending arrangement, each participating bank is responsible for the asset classification of its own share of the loan based on its actual record of recovery. If Bank B does not receive its portion of the borrower's payment from the lead bank, it must classify the account as non-performing in their books, regardless of whether the borrower has paid the lead bank.

74. (A) P-2, Q-1, R-4, S-3

General provisioning rates for standard assets are tailored to the risk profiles of different sectors. Farm credit and small enterprises require a low provision of zero-point-two-five percent. Commercial real estate advances attract a one percent provision, while medium enterprises are at zero-point-four percent. Housing loans with teaser rates have the highest requirement at two

percent to mitigate risks during the low-interest period.

75. (A) The direct loan becomes NPA if any credit facility granted to the borrower by the PACS is classified as NPA.

The principle of borrower-wise asset classification applies even across different lending channels provided by the same bank. If a borrower defaults on a facility provided through a Primary Agricultural Credit Society under an on-lending arrangement, any direct credit facility granted by the commercial bank to that same borrower must also be classified as a non-performing asset to reflect the borrower's total credit risk.

76. (A) P-3, Q-2, R-4, S-1

Special Mention Account sub-categories provide a granular view of credit stress. SMA-zero indicates incipient stress without a long overdue period. For non-revolving facilities, SMA-one and SMA-two represent overdue periods of thirty-one to sixty days and sixty-one to ninety days respectively. For revolving facilities, SMA-one is defined by the outstanding balance exceeding the sanctioned limit or drawing power for thirty-one to sixty days.

77. (B) ₹12 Lakhs (40% of secured) + ₹20 Lakhs (100% of unsecured) = ₹32 Lakhs.

For an asset in the doubtful category for two years, the provisioning requirement includes forty percent of the secured portion and one hundred percent of the unsecured portion. In this case, forty percent of the thirty lakh secured amount is twelve lakhs, and the entire twenty lakh unsecured portion must be provided for. Combining these amounts results in a total provisioning requirement of thirty-two lakh rupees.

78. (A) P-3, Q-4, R-1, S-2

Provisioning requirements increase as an asset remains non-performing for longer periods. Substandard assets generally require a fifteen percent provision. Once classified as doubtful, the rate for the secured portion starts at twenty-five percent for the first year, increases to forty percent for the second and third years, and finally reaches one hundred percent once the asset has been doubtful for more than three years.

May/June 2009

18. Read the following statements regarding liquidity planning and select the correct option.
Statement I: As all banks are affected by changes in the economic climate, the monitoring of economic and money market trends is the key to liquidity planning.
Statement II: A sound financial management can accentuate the negative effects of these trends while minimising the positive ones.
(A) Statement I is correct and Statement II is incorrect.
(B) Statement I is incorrect and Statement II is correct.
(C) Both Statement I and Statement II are correct.
(D) Both Statement I and Statement II are incorrect.

Oct/Nov 2011

19. For banks with funding requirements in foreign currencies, consider the following management structures:
I. Completely centralising liquidity management at the head office for every currency.
II. Decentralising by assigning operating divisions responsibility for their own liquidity, subject to limits imposed by the head office.
III. Assigning responsibility for liquidity in the home currency to the home office, and global liquidity in each major foreign currency to the foreign office in the issuing country.
Which of the above statement(s) is/are correct?
(A) I and II
(B) II and III
(C) I and III
(D) I, II, and III

May/June 2010

20. Which of the following is an explicit step necessary for managing liquidity risk in banks?
(A) Setting tolerance level and limit for liquidity risk.
(B) Setting zero tolerance for any asset-liability maturity mismatches.
(C) Eliminating all off-balance sheet commitments.
(D) Centralising all customer relationship management.

Oct/Nov 2024

21. Bank X has significantly increased its reliance on market borrowings to fund rapid asset growth. Consequently, its Ratio of Volatile Liabilities to Total Assets has sharply risen over the past quarter. How does this impact the bank's liquidity assessment under the stock approach?
(A) It improves the liquidity position as market borrowings provide stable, long-term funding for the bank's core operational activities.
(B) It has no impact on liquidity as long as the market borrowings are used to fund fixed assets and long-term capital investments.
(C) It indicates a deteriorating liquidity position, as a higher ratio of volatile liabilities signifies potential funding problems.
(D) It implies that the bank has effectively replaced core deposits with less risky capital funds to meet regulatory requirements.

May/June 2017

22. Why are banks with strong balance sheets able to buy funds at a lower risk premium?
(A) Because they exclusively rely on short-term wholesale market borrowings to fund their long-term infrastructure and development projects.
(B) Because the market perceives them as liquid and safe relative to their overall creditworthiness.
(C) Because they strictly avoid making any prior loan commitments, whether formal or informal, to maintain maximum capital reserves.
(D) Because they follow a strategy of converting all their fixed assets and long-term investments into liquid demand deposits.

Oct/Nov 2005

23. How is 'Time Risk' defined in the context of liquidity exposure?
(A) The risk arising from the need to replace net outflows due to unanticipated pre-mature closure of deposits.
(B) The risk arising from the inability to undertake profitable business initiatives due to swaps and options.
(C) The systemic risk generated by geographical distances between banking branches.
(D) The risk arising from the need to compensate for non-receipt of expected inflows of funds.

CHAPTER 29

Liquidity Management

Oct/Nov 2018

1. Consider the following factors used to analyze the adequacy of a bank's liquidity position:
 - I. Historical funding requirements
 - II. Options for reducing funding needs
 - III. Present and anticipated asset quality
 - IV. Present and planned capital positionWhich of the above statement(s) is/are correct?
 - (A) I, II, and III
 - (B) II, III, and IV
 - (C) I, III, and IV
 - (D) I, II, III, and IV

May/June 2007

2. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): The treatment of assets and liabilities in multiple currencies adds a layer of complexity to liquidity management.

Reason (R): In the event of market concerns, liability holders in foreign currency markets may not be able to distinguish rumours from fact as well or as quickly as domestic currency customers.

 - (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2025

3. How does liquidity risk typically interact with the solvency of a financial institution?
 - (A) Liquidity risk directly and immediately threatens the solvency of the bank by forcing an immediate cessation of all lending and operational activities.
 - (B) Liquidity risk is considered synonymous

with solvency risk and mandates the identical regulatory capital buffer to absorb potential losses.

- (C) Liquidity risk is typically a normal management issue, only becoming a solvency threat in extreme cases.
- (D) Liquidity risk reduces solvency risk because it ensures the marketability of the bank's long-term assets while increasing short-term yields.

May/June 2012

4. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): When calculating limits on cumulative cash flow mismatches, the bank should take an aggressive view of the marketability of liquid assets at full face value.

Reason (R): The calculation of mismatches must include a discount to cover price volatility and any drop in price in the event of a forced sale.

 - (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2014

5. Which of the following pairs correctly matches a liquidity risk category with its originating cause?
 - (A) Call Risk — Temporary problems in recovery of funds
 - (B) Funding Risk — Unanticipated withdrawal or non-renewal of deposits
 - (C) Time Risk — Conversion of non-fund based limit into fund-based
 - (D) Funding Risk — Standard assets turning

- (A) Immediately ceasing all foreign currency lending operations and recalling all outstanding foreign loans to bolster domestic reserves.
- (B) Requesting the host country's central bank to automatically honour all foreign liabilities without collateral or prior agreements.
- (C) Converting home currency sources through exchange markets or utilizing pre-arranged back-up foreign currency sources.
- (D) Converting all foreign liabilities into long-term equity to prevent withdrawal and stabilize the bank's international capital base.

May/June 2006

30. A bank has issued several significant letters of credit and financial guarantees. Due to a sudden market downturn, multiple clients default, leading to the crystallisation of these contingent liabilities and compelling the bank to fund these obligations immediately. This scenario best exemplifies which type of liquidity risk?
- (A) Funding Risk
 - (B) Time Risk
 - (C) Geographic Risk
 - (D) Call Risk

Oct/Nov 2017

31. Bank Z is constructing its maturity ladder. It holds a portfolio of commercial loans maturing in 15 days, a commitment line that a corporate client can draw upon starting tomorrow, and term deposits maturing in 30 days. How should these items be correctly allocated on the maturity ladder?
- (A) Loan maturities as cash outflows in 15 days; drawdowns as cash inflows tomorrow; term deposits as cash inflows in 30 days.
 - (B) Loan maturities as cash outflows tomorrow; drawdowns as cash inflows in 15 days; term deposits as cash outflows in 30 days.
 - (C) Loan maturities as cash inflows in 15 days; drawdowns as cash outflows tomorrow; term deposits as cash outflows in 30 days.
 - (D) All items should be placed as cash inflows on the date of their original creation.

May/June 2008

32. Consider the following questions used to determine the level of a bank's potential assets:
- I. What proportion of maturing assets will

a bank be able and willing to roll over or renew?

- II. What is the expected level of new loan requests that will be accepted?
- III. What is the expected level of drawdowns of commitments to lend that a bank will need to fund?

Which of the above statement(s) is/are correct?

- (A) I and II
- (B) I, II, and III
- (C) II and III
- (D) I and III

Oct/Nov 2013

33. Which of the following is a standard stock ratio used in the assessment of bank liquidity?
- (A) Contingent Liabilities / Net Worth excluding intangible assets and deferred tax assets.
 - (B) (Cash + Balances with Central Bank + Government Securities) / Total Assets.
 - (C) Off-balance sheet items / Total Deposits including both core and wholesale deposits.
 - (D) Risk-Weighted Assets / Core Capital inclusive of Tier I and Tier II capital reserves.

May/June 2015

34. Match the Liability Category/Type (List I) with its expected behaviour in a crisis scenario (List II).

List I: (Liability Category)

- P. First Category Liabilities (e.g., retail transactions accounts)
- Q. Second Category Liabilities (e.g., certain interbank funding)
- R. Third Category Liabilities (e.g., wholesale deposits)
- S. Contingent Liabilities (e.g., letters of credit)

List II: (Expected Behaviour)

- 1. May trigger a substantial increase in drawdowns due to an increase in defaults in the market.
- 2. Tend to reduce cash outflows and are thought to stay with a bank even under a 'worse-case' projection.
- 3. Are assumed to be repaid at the earliest possible maturity, representing immediate cash outflows.
- 4. Likely to stay during periods of mild difficulties and run off relatively slowly.

- (A) P-1, Q-2, R-4, S-3
- (B) P-4, Q-3, R-1, S-2
- (C) P-3, Q-1, R-2, S-4

- I. It demonstrates to the market place that the bank is safe and capable of repaying its borrowings.
- II. It forces the bank to sell assets at fire sale prices to generate immediate funds.
- III. It lowers the size of the default risk premium the bank must pay for funds.

Which of the above statements is/are correct?

- (A) I and II
- (B) II and III
- (C) I and III
- (D) I, II, and III

Oct/Nov 2016

- 13.** Consider the following statements regarding a bank's structure for managing liquidity risk:
- I. The liquidity strategy should set out the general approach to improve liquidity including quantitative and qualitative targets.
 - II. The strategy should enunciate specific policies on maintenance of cumulative gaps over certain periods.
 - III. The strategy should be kept strictly confidential within the Asset Liability Committee and not communicated to other business units.
 - IV. The responsibility of managing overall liquidity might be placed with an Asset Liability Committee comprising senior management.
 - V. The strategy should enunciate policies on the approach to managing liquidity in different currencies.

Which of the above statement(s) is/are correct?

- (A) I, II, IV, and V
- (B) I, II, III, and IV
- (C) II, III, IV, and V
- (D) I, III, IV, and V

May/June 2014

- 14.** An extensive fraud is uncovered in a major commercial bank, leading to widespread loss of public confidence. Depositors rush to prematurely close their accounts, creating a severe liquidity strain on the bank. Which specific type of liquidity risk has explicitly materialized in this scenario?
- (A) Time Risk
 - (B) Call Risk
 - (C) Funding Risk
 - (D) Instrument-specific Risk

Oct/Nov 2007

- 15.** Which of the following statements is correct regarding the Ratio of Core Deposit to Total Assets?
- (A) The lower the ratio, the better it is because core deposits represent highly volatile liabilities that are subject to immediate withdrawal.
 - (B) The ratio represents net advances after deduction of provision for loan losses and interest suspense account and is used to measure long-term asset growth.
 - (C) Core deposits in this ratio exclude deposits received from the public in the normal course of business to focus on institutional funds.
 - (D) The higher the ratio, the better, as core deposits are treated as a stable liquidity source.

May/June 2025

- 16.** What are the two-fold objectives of asset liability management?
- (A) Ensuring profitability and ensuring liquidity.
 - (B) Ensuring capital adequacy and ensuring rapid credit growth.
 - (C) Minimising operational risk and maximising shareholder wealth.
 - (D) Expanding market share and reducing non-performing assets.

Oct/Nov 2019

- 17.** Which of the following correctly pairs a tolerance limit parameter with its illustrative example?
- (A) Short-term cumulative gap — Limiting the difference between short-term liabilities and assets to 15% of total outflows.
 - (B) Mismatch levels for time buckets — Maintaining a 0% gap in the 1-14 days bucket by perfectly matching all cash flows and outflows.
 - (C) Loan to deposit ratio — Ensuring all core deposits are invested exclusively in government securities to maintain a high liquidity ratio.
 - (D) Minimum liquidity provision — Capping the reliance on certificates of deposits to 100% of total liabilities to manage funding costs.

62. (C) Loans to Corporate entities with aggregate exposure of ₹50 million and above
Banks are required to report credit information for borrowers with an aggregate exposure of fifty million rupees or more to the Central Repository of Information on Large Credits. While certain categories like interbank exposures, crop loans, and exposures to institutions like NABARD are exempt from this reporting, all standard loans to corporate entities exceeding the threshold must be included in the report.

63. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Generally, if all arrears of interest and principal are paid, a non-performing loan account can be upgraded to standard status. However, for Micro, Small, and Medium Enterprises, there are specific additional requirements, including a one-year period of satisfactory performance. While both statements regarding the upgradation of accounts are factually correct, the specific MSME rule does not serve as the explanation for the general rule.

64. (D) Inter-bank participations

The regulatory guidelines for the transfer of assets via direct assignment of cash flows are designed for the sale of loan pools to other entities. These rules cover various retail and non-retail loan transfers and set requirements for minimum retention. However, they specifically exclude inter-bank participation certificates and the trading of bonds, which are governed by different sets of financial and banking regulations.

65. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Asset classification is conducted on a borrower-wise basis because a default in one credit facility usually signals a broader financial problem for the debtor. Therefore, if a borrower fails to repay a term loan, it is logically consistent to classify their cash credit facility as non-performing as well. This approach ensures that the total risk associated with a single borrower is accurately reflected in the bank's books.

66. (C) Insolvency Professionals

The Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code can

be initiated by three specific classes of persons. Financial creditors, who have extended debt, and operational creditors, who are owed for goods or services, can trigger the process. The corporate debtor itself can also voluntarily file for insolvency. Insolvency professionals manage the process but do not have the legal standing to trigger it.

67. (A) As an NPA, because the account has remained 'out of order' for more than 90 days.

An overdraft facility is classified as a non-performing asset if it remains out of order for more than ninety days. In this scenario, the outstanding balance has exceeded the sanctioned limit for ninety-five days with no credits to the account. This continuous breach of the limit beyond the ninety-day threshold satisfies the regulatory definition of an out of order account, requiring an NPA classification.

68. (D) It is recognised at market value on conversion date, not exceeding the interest amount converted. When a bank converts overdue interest into quoted equity shares, the income can be recognised based on the market value of those shares on the date of conversion. However, the amount of income recognised cannot exceed the total amount of interest that was originally converted. This prudential limit prevents banks from recording excessive profits based solely on volatile equity market valuations during the conversion.

69. (D) The bank should adopt a consistent accounting principle to exercise the right of appropriation of recoveries.

In cases where a borrower makes a partial payment on a non-performing asset and there is no specific agreement on how to apply the funds, the bank must follow a consistent accounting policy. The right of appropriation allows the bank to choose whether to apply the payment toward the principal or the interest, provided the chosen method is applied uniformly across its loan portfolio.

70. (B) Crops with a crop season longer than one year.

For the purpose of applying non-performing asset norms to agricultural advances, crops are categorized by the length of their growing

May/June 2020

24. Bank management or supervisors may set limits to ensure liquidity. Consider the following limits:
- A limit on loan to deposit ratio.
 - A general limit on the relationship between anticipated funding needs and available sources.
 - Flexible limits on the minimum/maximum average maturity of different categories of liabilities.
 - A limit prohibiting any reliance on wholesale deposit funding under all circumstances.
- Which of the above statement(s) is/are correct?
- I and II only
 - II, III, and IV
 - I, III, and IV
 - I, II, and III

Oct/Nov 2015

25. Why does the analysis of liquidity require bank management to examine how funding requirements are likely to evolve under crisis scenarios?
- Because crisis scenarios guarantee that central banks will immediately inject unlimited capital and liquidity into any bank facing difficulties.
 - Liquidity importance transcends the individual institution because a single shortfall can have systemic repercussions.
 - Because examining crisis scenarios allows the bank to eliminate regulatory capital reserve requirements and focus on short-term yield.
 - Because historical funding requirements perfectly predict future crisis outflows and allow for the creation of static management plans.

May/June 2013

26. Which of the following statements is correct regarding a bank's ability to meet its liquidity needs?
- A bank possesses adequate liquidity only when it can secure necessary funding exclusively by decreasing liabilities and increasing capital.
 - The price of liquidity is entirely independent of the market's perception of interest rate volatility, credit risks, and general economic health.

- Liability management is considered non-essential in modern banks as balance sheet fluctuations are generally predictable and easily managed.
- Unmet liquidity needs may force a bank to restructure or acquire high-cost liabilities under adverse market conditions.

Oct/Nov 2021

27. When setting a limit on liquid assets as a percentage of short-term liabilities, what specific criteria must the included assets meet?
- They must be highly liquid, judged to have a ready market even in periods of stress.
 - They must be long-term structural investments that offer the highest yield and significant capital appreciation.
 - They must exclusively be unmarketable assets such as bank premises.
 - They must be non-performing assets that require immediate restructuring.

May/June 2024

28. Match the Type of Liquidity Risk (List I) with its specific cause or driver (List II).

List I: (Type of Liquidity Risk)

- Funding Risk
- Time Risk
- Call Risk
- Internal liquidity risk

List II: (Cause/Driver)

- Perceptions of an institution in its various local, regional, or international markets
- Unanticipated withdrawal or non-renewal of wholesale and retail deposits
- Crystallisation of contingent liabilities and conversion of non-fund based limits
- Non-receipt of expected inflows due to standard assets turning into non-performing assets

- P-2, Q-4, R-3, S-1
- P-1, Q-3, R-4, S-2
- P-4, Q-2, R-1, S-3
- P-3, Q-1, R-2, S-4

Oct/Nov 2008

29. A bank conducting business in multiple currencies must develop a back-up liquidity strategy for circumstances in which its normal approach to funding foreign currency operations is disrupted. Which of the following is the most appropriate action under such a strategy?

NODIA

into non-performing assets

May/June 2019

6. Which of the following statements is incorrect concerning the Net Loans to Total Deposits Ratio?
- (A) Total loans in this ratio represent net advances after deduction of provision for loan losses and interest suspense account.
 - (B) The higher the ratio, the better it is for the bank's liquidity position.
 - (C) Loan is treated to be a less liquid asset.
 - (D) It reflects the ratio of loans to public deposits or core deposits.

Oct/Nov 2006

7. What does liquidity represent in the context of bank financial management?
- (A) The capacity to increase liabilities and to fund decreases in assets.
 - (B) The ability to accommodate decreases in liability and to fund increases in assets.
 - (C) The process of ensuring maximum profitability by converting liquid assets into long-term investments.
 - (D) The conversion of fixed assets into short-term liabilities to meet daily operational costs.

May/June 2021

8. Which of the following statements is incorrect regarding the development of a structure for managing liquidity risk?
- (A) The transformation of illiquid assets into more liquid ones is a key activity of banks that requires robust internal controls.
 - (B) Liquidity management responsibility should be decentralised to branch managers without any head office oversight.
 - (C) The liquidity strategy should address the bank's goal of protecting financial strategy and the ability to withstand extreme stressful events.
 - (D) The Board should monitor the performance and liquidity risk profile of the bank periodically to ensure alignment with risk appetite.

Oct/Nov 2010

9. A non-European bank assigns its London office the sole responsibility for managing its liquidity for European operations in all

currencies. The London office must frequently and routinely report to the bank's head office, which imposes strict liquidity limits. Which approach to managing foreign currency funding requirements is this bank employing?

- (A) Complete centralisation of liquidity management.
- (B) Decentralisation subject to head office limits.
- (C) Assigning global responsibility for each currency to the issuing country's office.
- (D) Pure domestic funding strategy with currency swaps.

May/June 2005

10. To provide funds to satisfy its funding needs, a bank must perform one or a combination of several actions. Which of the following is NOT one of these specified actions?
- (A) Dispose of liquid assets
 - (B) Increase short-term borrowings
 - (C) Increase holdings of less liquid assets
 - (D) Increase capital funds

Oct/Nov 2022

11. Match the Ratio (List I) with its correct interpretation (List II).

List I: (Ratio)

- P. Ratio of Time Deposits to Total Deposits
- Q. Ratio of Volatile Liabilities to Total Assets
- R. Ratio of Liquid Assets to Total Assets
- S. Ratio of Short-Term Liabilities to Total Assets

List II: (Interpretation)

- 1. Higher portion causes problems; the lower the ratio, the better it is.
 - 2. Ensures better/comfortable liquidity; the higher the ratio, the better it is.
 - 3. Provides a stable level of liquidity with negligible volatility; the higher the ratio, the better it is.
 - 4. Includes balances in current account; a lower ratio is desirable.
- (A) P-1, Q-4, R-3, S-2
 - (B) P-4, Q-2, R-1, S-3
 - (C) P-2, Q-3, R-4, S-1
 - (D) P-3, Q-1, R-2, S-4

May/June 2018

12. Consider the following statements regarding the purposes served by effective liquidity management:

(D) P-2, Q-4, R-3, S-1

Oct/Nov 2012

35. What is the primary usefulness of establishing a benchmark under the 'General Market Conditions' scenario?
- (A) It assists in managing funding requirements to avoid large needs on specific days and prevent rollover constraints.
 - (B) It determines the exact date when the bank will fail due to credit default and total depletion of capital reserves.
 - (C) It ensures that central banks will provide unlimited overdraft facilities regardless of the bank's collateral quality.
 - (D) It restricts the bank from using any deposit and other debt markets to fund its core commercial activities.

May/June 2011

36. Bank M has a significant portfolio of letters of credit and financial guarantees. Normally, these represent stable, predictable outflows. However, a severe general market crisis occurs. How should Bank M adjust its liquidity assumptions regarding these off-balance sheet activities?
- (A) It should estimate a significant increase in drawdowns due to rising market defaults and bankruptcies.
 - (B) It should assume zero cash outflows because all letters of credit and guarantees are immediately cancelled in a crisis.
 - (C) It should expect massive cash inflows as clients deposit extra collateral to secure their outstanding contingent guarantees.
 - (D) It should assume no change in outflows, as off-balance sheet items are not dependent on broader market conditions.

Oct/Nov 2020

37. What does liquidity represent in the context of bank financial management?
- (A) The capacity to increase liabilities and to fund decreases in assets.
 - (B) The ability to accommodate decreases in liability and to fund increases in assets.
 - (C) The process of ensuring maximum profitability by converting liquid assets into long-term investments.
 - (D) The conversion of fixed assets into short-term liabilities to meet daily operational costs.

May/June 2022

38. Consider the following statements regarding adjustments made to a Maturity Ladder during crisis scenarios:
- I. Many maturing loans that would be rolled over in normal conditions might not be rolled over in a crisis.
 - II. In a general market crisis, cash inflows from asset sales generally decrease compared to normal conditions.
 - III. Drawdowns on commitments by clients usually decrease to zero in a general market crisis.
 - IV. Other deposit run-offs typically increase significantly in a bank-specific crisis compared to normal conditions.
 - V. The timing of cash inflows and outflows on the maturity ladder can differ between the normal business approach and the crisis scenarios.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and V
- (B) II, III, IV, and V
- (C) I, III, IV, and V
- (D) I, II, IV, and V

Oct/Nov 2023

39. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.
- Assertion (A): Different banks could assign the exact same asset to different liquidity categories on the maturing ladder.
- Reason (R): Differences in internal asset-liability management, loan documentation clauses, and networks of customers for loan-purchases influence an asset's recognized liquidity.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2016

40. What is the correct logical and chronological order of the following steps for constructing a maturity ladder?

NODIA

- I. Calculate the excess or deficit of funds as a starting-point measure.
 - II. Allocate each cash inflow or outflow to a given calendar date from a starting point, usually the next day.
 - III. Rank cash inflows by the date on which assets mature and outflows by the date liabilities fall due.
- (A) I, II, III
 - (B) II, III, I
 - (C) III, I, II
 - (D) II, I, III

Oct/Nov 2009

41. Which of the following pairs is incorrectly matched regarding “other assumptions” that have a significant impact on a bank’s cash flows?
- (A) Inter-company financing — Requires understanding and evaluation for individual business officers to manage market access.
 - (B) Clearing services — Generate significant and predictable cash flows entirely independent of correspondent banks’ clearing columns.
 - (C) Net overhead expenses — Rent and salary, although generally not significant enough to be considered, can be sources of cash outflows in some cases.
 - (D) Provider of funds — Checking reliance on individual funding sources to ensure adequate diversification of liabilities.

May/June 2023

42. In the gap method of measuring and managing liquidity, what does the ‘gap’ for a specific time bucket represent?
- (A) The original contractual lifespan of an asset from its origination date.
 - (B) The percentage of core deposits that never mature.
 - (C) The net cash flow, representing the difference between outflows and inflows in future time buckets.
 - (D) The amount of capital funds held against non-performing assets.

Oct/Nov 2018

43. While banks may consider long-term information useful, the relevant time frame for active liquidity management is generally short. For most banks, active management of net funding requirements extends out to a period of:
- (A) No more than one day.

- (B) No longer than four or five weeks.
- (C) Exactly one to three years.
- (D) Over five years.

May/June 2007

44. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): In a bank-specific crisis scenario, a key underlying assumption is that the bank would have to wind down its books to some degree.

Reason (R): It is assumed that many of the bank’s liabilities could not be rolled over or replaced and would have to be repaid at maturity.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2025

45. When evaluating the extent of liability run-off and a bank’s capacity to replace funds in the third category (maturing wholesale deposits), factors seen as especially important include diversification and relationship building. Which of the following is NOT a typical behaviour for these liabilities under a conservative stance in a crisis scenario?

- (A) The liabilities are repaid at the earliest possible maturity.
- (B) The money may flow to government securities and other safe havens.
- (C) All these liabilities automatically convert to long-term equity to absorb losses.
- (D) High quality institutions may find they receive larger-than-usual wholesale deposit inflows.

May/June 2012

46. Consider the following asset types:
- I. Bank balances and money at call and short notice.
 - II. Cash balances with the bank and balances with the central bank.
 - III. Securities held for trading and available for

sale with a ready market.

Which of the above can be included in Liquid Assets or Prime Assets for ratio calculations?

- (A) I and II
- (B) I, II, and III
- (C) II and III
- (D) I and III

Oct/Nov 2014

47. When projecting cash flows during a crisis, Bank Y categorises its retail and small business transactions accounts in the “first category” of liabilities. Even under a ‘worse-case’ projection, Bank Y assumes these deposits will stay with the bank. What is the primary rationale for this assumption?

- (A) Because retail depositors are legally prohibited by regulatory statutes from withdrawing any funds during a declared financial crisis.
- (B) Retail depositors rely on the safety net, and switching costs for transaction accounts are prohibitive in the short run.
- (C) Because these deposits are contractually locked in for a minimum of five years and do not offer any early withdrawal options.
- (D) Because wholesale depositors and institutional investors provide a guarantee for the stability of all small business and retail accounts.

May/June 2019

48. Consider the following statements regarding the construction of a maturity ladder:

- I. Maturing assets represent cash inflows.
- II. Saleable non-maturing assets represent cash inflows.
- III. Liabilities falling due represent cash outflows.
- IV. Committed lines of credit that can be drawn down represent cash inflows.

Which of the above statement(s) is/are correct?

- (A) II, III, and IV
- (B) I, II, and III
- (C) I, III, and IV
- (D) I, II, III, and IV

Oct/Nov 2006

49. How should the bank treat assets that are pledged to third parties?
- (A) Pledged assets must be deducted from each respective category.

- (B) Pledged assets must be added to Category A.
- (C) Pledged assets are reclassified exclusively as Category B.
- (D) Pledged assets are ignored in liquidity analysis.

May/June 2021

50. Read the following statements regarding the ability to control future cash flows from saleable assets and select the correct option.

Statement I: In a bank-specific crisis, a bank may believe its capacity to sell assets would deteriorate little from normal conditions.

Statement II: In a general market crisis, the capacity to sell less liquid assets may fall off sharply if few institutions are willing or able to make cash purchases.

- (A) Statement I is correct and Statement II is incorrect.
- (B) Statement I is incorrect and Statement II is correct.
- (C) Both Statement I and Statement II are correct.
- (D) Both Statement I and Statement II are incorrect.

Oct/Nov 2010

51. Read the following statements regarding swaps and options during a crisis and select the correct option.

Statement I: If a bank is a swap market-maker, customers with in-the-money swap positions may seek to reduce their credit exposure to the bank by asking the bank to buy outstanding warrants.

Statement II: Such exercise and repurchase requests could result in an unforeseen cash drain if hedges are quickly liquidated to generate cash.

- (A) Statement I is correct and Statement II is incorrect.
- (B) Statement I is incorrect and Statement II is correct.
- (C) Both Statement I and Statement II are correct.
- (D) Both Statement I and Statement II are incorrect.

May/June 2005

52. Under the flow approach, what action must a bank take if the cumulative gap at a particular time bucket is negative?

- (A) The bank must immediately declare

insolvency and suspend all payment operations to protect remaining depositors.

- (B) The bank is required to write off the corresponding liabilities from its balance sheet to restore the capital adequacy ratio.
- (C) The bank must convert the negative gap into off-balance sheet contingent liabilities to improve the structural liquidity profile.
- (D) The bank must manage the shortfall through sources defined in its liquidity policy and strategy.

Oct/Nov 2022

53. What are the three scenarios that provide useful benchmarks for a bank in connection with management of liquidity?
- (A) Normal Business Conditions, Structural Crisis, and Foreign Exchange Crisis
 - (B) Positive Liquidity Swing, Negative Liquidity Swing, and Neutral Market Stance
 - (C) General Market Conditions, Bank-specific Crisis, and General Market Crisis
 - (D) Short-term Funding Scenario, Long-term Funding Scenario, and Contingency Scenario

May/June 2018

54. To evaluate the cash flows arising from a bank's liabilities under normal business conditions, a bank must first establish:
- (A) Determining the liquidation value of bank premises and the projected default rate of borrowers during economic downturns.
 - (B) Calculating the maximum penalty for premature closure of fixed deposits by corporate clients and high-net-worth individuals.
 - (C) Establishing normal levels of deposit roll-overs, the maturity of non-contractual deposits, and the growth in new accounts.
 - (D) Assessing the extent of potential drawdowns on letters of credit and other guarantees in a general market crisis scenario.

Oct/Nov 2016

55. Which of the following statements is correct regarding measuring liquidity over a chosen time-frame using a stylised liquidity graph?
- (A) High-quality banks may appear liquid in going-concern and market-crisis scenarios, but only marginally so in bank-specific crises.
 - (B) A weaker institution will look far more liquid

in a general market crisis than it would in a bank-specific crisis due to systemic support.

- (C) The evolution of a bank's liquidity profile cannot be tabulated or portrayed graphically due to the volatility of cash flow data.
- (D) The relevant time frame for active liquidity management is strictly limited to one day for all domestic and international institutions.

May/June 2014

56. Which of the following pairs is incorrectly matched regarding the major dimensions of the flow approach to assessing bank liquidity?
- (A) Contingency planning — Developing assumptions for determining cash flows
 - (B) Managing net funding requirements — Construction of a maturity ladder
 - (C) Managing market access — Exploring arrangements to borrow against assets
 - (D) Measuring net funding requirements — Calculating cumulative gap at various time buckets

Oct/Nov 2007

57. When examining the cash flows arising from a bank's liabilities in crisis scenarios, consider the following questions:
- I. Which sources of funding are likely to stay with a bank under any circumstances?
 - II. Which sources of funding can be expected to run off gradually if problems arise and at what rate?
 - III. Does the bank have back-up facilities that it can drawdown?
 - IV. What is the expected level of new loan requests that will be accepted?
- Which of the above statement(s) is/are correct?
- (A) I, II, and III
 - (B) I, II, and IV
 - (C) II, III, and IV
 - (D) I, III, and IV

May/June 2025

58. Based on the maturity ladder framework, which of the following is NOT typically classified as a cash outflow?
- (A) Established credit lines that can be tapped by the bank
 - (B) Maturity liabilities with contractual maturities
 - (C) Interest payable
 - (D) Drawdown on committed lines

Oct/Nov 2019

59. Which of the following statements is incorrect regarding the categorization of assets by their degree of relative liquidity?
- (A) The most liquid category includes cash on hand, government securities, and short-term interbank loans.
 - (B) A less liquid category comprises a bank's saleable loan portfolio and other marketable debt instruments.
 - (C) Pledged assets are automatically classified as liquid due to the underlying collateral value.
 - (D) The least liquid category includes structural assets like bank premises and long-term investments in subsidiaries.

May/June 2009

60. During a sudden systemic economic shock affecting all institutions, interbank lending freezes and differences in funding access among classes of financial institutions widen significantly. Weaker banks suffer severe liquidity drain, while some highly reputed banks receive larger-than-usual wholesale deposit inflows due to a flight to quality. This situation is the core assumption of which liquidity analysis scenario?
- (A) General Market Conditions
 - (B) General Market Crisis
 - (C) Bank-specific Crisis
 - (D) Going-concern Scenario

Oct/Nov 2011

61. Read the following statements regarding maintaining customer relationships during a crisis and select the correct option.
Statement I: As the intensity of a crisis increases, banks must often trade off relationships with some customers for liquidity in order to survive.
Statement II: In a crisis, relationships with lenders become more important, and maintaining strong on-going links with them during calm periods positions the bank better during emergencies.
- (A) Statement I is correct and Statement II is incorrect.
 - (B) Statement I is incorrect and Statement II is correct.
 - (C) Both Statement I and Statement II are correct.
 - (D) Both Statement I and Statement II are

incorrect.

May/June 2010

62. Which of the following statements correctly applies the principles of ratio analysis for liquidity risk measurement?
- (A) A lower 'Net Loans to Total Deposits' ratio indicates better liquidity, as loans are less liquid than other assets.
 - (B) For the ratio of 'Core Deposit to Total Assets', a lower ratio is better because core deposits are considered highly volatile.
 - (C) For the ratio of 'Time Deposits to Total Deposits', a lower ratio is better because time deposits provide negligible volatility.
 - (D) For the ratio of 'Market Liabilities to Total Assets', the higher the ratio, the better it is for the bank's liquidity.

Oct/Nov 2024

63. Bank Alpha maintains regular, active borrowing arrangements with several major institutional funds and frequently renews its contracts with them, even when it does not strictly need the liquidity. What is the strategic purpose of this practice in liquidity management?
- (A) Building relationships with providers through frequent use creates a line of defence against liquidity problems.
 - (B) To artificially inflate the size of the balance sheet to deter hostile takeovers and increase the market value of the bank's stock.
 - (C) To increase the bank's vulnerability to market rumours and ensure it is treated as a systemic risk by the central bank.
 - (D) To automatically convert wholesale deposits into retail demand deposits to satisfy internal risk management quotas.

May/June 2017

64. What is the correct sequential order of the first four time buckets for classifying assets and liabilities in a liquidity statement?
- I. 15–30 days
 - II. Tomorrow
 - III. 8–14 days
 - IV. 2–7 days
 - (A) II, IV, III, I
 - (B) II, III, IV, I
 - (C) IV, II, III, I
 - (D) I, III, IV, II

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Oct/Nov 2005

65. What does liquidity represent in the context of bank financial management?
- The capacity to increase liabilities and to fund decreases in assets.
 - The ability to accommodate decreases in liability and to fund increases in assets.
 - The process of ensuring maximum profitability by converting liquid assets into long-term investments.
 - The conversion of fixed assets into short-term liabilities to meet daily operational costs.

May/June 2020

66. A bank projects a significant net funding requirement 30 days hence. To actively manage this gap, the bank decides today to deliberately acquire a specific asset that matures exactly on that 30th day. According to the flow approach and active liquidity management principles, what is the primary objective of this action?
- To increase the overall size of the funding gap and create additional volatility in the bank's interest income.
 - To offset the upcoming funding gap by influencing the specific maturity of transactions.
 - To trigger an immediate bank-specific crisis and test the efficiency of the internal risk management response team.
 - To convert all home currency liabilities into foreign currencies and reduce the total amount of risk-weighted assets.

Oct/Nov 2015

67. Faced with an extreme systemic liquidity shortage, a bank's contingency plan mandates the use of "Back up Liquidity for Emergency Situations." Which of the following actions directly executes this specific part of the plan?
- Issuing a detailed press release formally denying any financial trouble or potential liquidity constraints to the media.
 - Classifying all moderately liquid assets as unmarketable to prevent their sale at a discount during periods of stress.
 - Utilizing unused credit facilities and drawing upon pre-arranged lines from the domestic central bank.
 - Refusing to honour any non-binding lending commitments to preserve the bank's existing

cash reserves for operations.

May/June 2013

68. Consider the following components of a strategy for dealing with a crisis:
- Procedures to ensure that information flows remain timely and uninterrupted.
 - A clear division of responsibility so that all personnel understand what is expected of them.
 - A strategy for taking certain actions to alter asset and liability behaviours.
- Which of the above statement(s) is/are correct?
- I and II
 - I, II, and III
 - II and III
 - I and III

Oct/Nov 2021

69. Consider the following factors that may affect a bank's liquidity:
- A decline in earnings
 - An increase in non-performing assets
 - Downgrading by rating agencies
 - Expanded business opportunities
 - New tax initiatives
- Which of the above statement(s) is/are correct?
- I, II, and III
 - I, II, III, and V
 - II, III, IV, and V
 - I, II, III, IV, and V

May/June 2024

70. Match the Time Duration (List I) to its correct subsequent Maturity Bucket category (List II).
- List I: (Duration)
- Up to 3 months
 - Up to 6 months
 - Up to 1 year
 - Up to 3 years
- List II: (Bucket Category)
- Over 6 months and...
 - Over 1 year and...
 - Over 2 months and...
 - Over 3 months and...
- P-1, Q-2, R-3, S-4
 - P-4, Q-3, R-2, S-1
 - P-3, Q-4, R-1, S-2
 - P-2, Q-1, R-4, S-3

Oct/Nov 2008

71. What are two possible indicators of a bank's ability to quickly execute asset sales under adverse scenarios?
- (A) The total number of operational bank branches and the technical size of its automated teller machine (ATM) network.
 - (B) The ratio of core deposits to total assets and the current amount of reserves held at the domestic central bank.
 - (C) The recent downgrading of the institution by rating agencies and the rising level of non-performing assets.
 - (D) The use of loan-sale clauses in documentation and the frequency of activity in asset-sales markets.

May/June 2006

72. The following question consists of two statements, one labeled as Assertion (A) and the other as Reason (R). Examine these two statements carefully and select the correct answer.

Assertion (A): How a bank deals with the press and broadcast media is a pragmatic and important element of liquidity management during a crisis.

Reason (R): Astute public relations management can help a bank avoid the spread of baseless public rumours that can result in significant run-offs by retail depositors and institutional investors.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2017

73. Consider the following summary statements regarding liquidity management concepts:
- I. Liquidity risk is a normal aspect of everyday management of a financial institution.
 - II. Funding risk arises due to unanticipated withdrawal or non-renewal of deposits.
 - III. Time risk relates to the non-receipt of expected inflows of funds.
 - IV. Call risk relates to the crystallisation of contingent liabilities.

- V. The stock approach is based on the level of assets and liabilities on a particular date.

Which of the above statement(s) is/are correct?

- (A) I, II, III, and IV
- (B) I, II, III, IV, and V
- (C) I, III, IV, and V
- (D) II, III, IV, and V

May/June 2008

74. For DAY-1, a bank has Maturing assets of 150, Interest receivable of 50, and Drawdown on commitment lines (inflows) of 20. Its Outflows consist of Maturity liabilities of 100, Interest payable of 30, and Drawdown on commitment lines (outflows) of 40. What is the total Cash Inflow, total Cash Outflow, and the resulting Liquidity Management Excess/(Shortfall) before any management action?
- (A) Inflows: 200, Outflows: 150, Excess: 50
 - (B) Inflows: 220, Outflows: 170, Shortfall: 50
 - (C) Inflows: 170, Outflows: 220, Shortfall: 50
 - (D) Inflows: 220, Outflows: 170, Excess: 50

Oct/Nov 2013

75. During a sudden liquidity deficit, Bank Beta's contingency plan is activated. The management decides to market saleable assets more aggressively than under normal conditions and raises deposit rates significantly above the market average. What is the intended outcome of these specific actions?
- (A) To increase cash inflows from asset sales and retain deposits by offering higher rates, thereby slowing run-offs.
 - (B) To decrease cash inflows from asset sales and accelerate deposit run-offs by reducing the interest rates offered to customers.
 - (C) To legally default on outstanding loan commitments and suspend all interest payments to both retail and institutional creditors.
 - (D) To ensure the bank's immediate closure and formal handover of its remaining assets to the national regulatory authorities.

May/June 2015

76. What is the correct logical and chronological order of the following steps for constructing a maturity ladder?
- I. Calculate the excess or deficit of funds as a starting-point measure.
 - II. Allocate each cash inflow or outflow to a

- must reside with senior management or a dedicated committee. Decentralizing this critical function without head office supervision would lead to fragmented risk monitoring and could prevent the institution from maintaining a unified liquidity strategy.
9. (B) Decentralisation subject to head office limits. This management approach allows regional offices to handle the liquidity needs of specific geographic operations while remaining under strict corporate control. By requiring frequent reporting and imposing firm liquidity limits, the head office ensures that the local branch's activities align with the bank's global risk appetite. This balance provides operational flexibility while maintaining necessary centralized oversight and coordination.
 10. (C) Increase holdings of less liquid assets
To satisfy funding needs, a bank must focus on actions that generate immediate cash or enhance its financial stability. Disposing of liquid assets, increasing short-term borrowings, or raising capital funds are all effective methods for meeting liquidity requirements. Conversely, increasing holdings of less liquid assets would tie up funds and worsen the bank's ability to meet maturing obligations.
 11. (D) P-3, Q-1, R-2, S-4
Stock ratios provide vital insights into a bank's liquidity health by comparing different balance sheet components. Time deposits offer stability, while volatile liabilities can signal potential funding problems. High levels of liquid assets ensure a comfortable liquidity buffer, and monitoring short-term liabilities, including current account balances, helps manage immediate outflows. These ratios collectively help the bank maintain a balanced profile.
 12. (C) I and III
Effective liquidity management serves as a signal of safety and reliability to the broader financial marketplace. By demonstrating the ability to repay borrowings promptly, a bank maintains investor confidence and reduces the default risk premium it must pay for new funds. Sound management prevents the need for fire sales of assets, which would otherwise erode the bank's capital and profitability.
 13. (A) I, II, IV, and V
A comprehensive liquidity risk management structure involves establishing clear strategies and policies that are communicated throughout the organization. This includes setting quantitative targets, managing cumulative gaps, and addressing liquidity in various currencies. Senior management, often through an Asset Liability Committee, must oversee these strategies. Maintaining strict confidentiality within the committee is counterproductive, as business units need to understand the strategy.
 14. (C) Funding Risk
Funding risk specifically materializes when an institution experiences a sudden and unanticipated withdrawal of its deposits. In this scenario, the discovery of fraud triggers a loss of public confidence, leading to a rush of premature account closures. This mass exit of funds creates a severe strain on the bank's cash reserves, directly illustrating the dangers of concentrated funding risk.
 15. (D) The higher the ratio, the better, as core deposits are treated as a stable liquidity source. The Ratio of Core Deposit to Total Assets is a key indicator of funding stability. Core deposits, typically from retail customers, are less sensitive to interest rate changes and market volatility than wholesale funds. A higher ratio suggests that the bank relies on a steady, reliable source of funding, which reduces the likelihood of sudden, large-scale withdrawals during periods of stress.
 16. (A) Ensuring profitability and ensuring liquidity. Asset liability management is designed to balance two competing yet essential goals within a financial institution. First, it aims to ensure the bank maintains sufficient liquidity to meet all maturing obligations and funding commitments. Second, it seeks to optimize the bank's earnings and overall profitability. Achieving both objectives requires careful coordination of the maturity and pricing of assets and liabilities.
 17. (A) Short-term cumulative gap — Limiting the difference between short-term liabilities and assets to 15% of total outflows. Setting tolerance limits is a critical aspect of liquidity risk management. An example of this is defining a maximum allowable short-term

ANSWERS

1. (D) I, II, III, and IV
Assessing the adequacy of a bank's liquidity position involves a multi-dimensional analysis of various internal and external factors. This process includes reviewing historical funding requirements and identifying available options for reducing funding needs. Additionally, current and anticipated asset quality must be examined alongside the present and planned capital position to ensure a robust liquidity profile.
2. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Managing liquidity across multiple currencies introduces significant complexities for financial institutions. In foreign currency markets, liability holders often face informational disadvantages compared to domestic customers. This gap makes it difficult for them to distinguish market rumors from factual data during stressful periods, potentially leading to rapid withdrawals and increasing the overall volatility of foreign funding sources.
3. (C) Liquidity risk is typically a normal management issue, only becoming a solvency threat in extreme cases.
Liquidity risk is an inherent part of daily banking operations and is generally handled through routine asset and liability management. While it primarily involves managing cash flows and meeting obligations as they fall due, severe liquidity shortages can escalate rapidly. In extreme scenarios, an institution's inability to fund its operations may eventually lead to a total solvency crisis.
4. (D) Assertion (A) is false, but Reason (R) is true.
When calculating limits for cumulative cash flow mismatches, banks must avoid overly optimistic valuations of their liquid assets. It is essential to include a discount to account for price volatility and potential value drops during forced sales. Maintaining a conservative approach ensures that the institution has a realistic understanding of its available liquidity buffer during periods of market stress.
5. (B) Funding Risk — Unanticipated withdrawal or non-renewal of deposits
Funding risk is a primary category of liquidity risk that occurs when a bank faces unexpected changes in its liability base. This typically manifests through the unanticipated withdrawal of retail or wholesale deposits or the failure to renew maturing funds. Effectively managing this risk requires maintaining diverse funding sources and a stable core deposit base to handle sudden outflows.
6. (B) The higher the ratio, the better it is for the bank's liquidity position.
The Net Loans to Total Deposits ratio measures the proportion of a bank's illiquid assets funded by its deposits. Since loans are generally difficult to convert into cash quickly without significant loss, a higher ratio indicates lower institutional liquidity. Banks prefer a moderate ratio to ensure they have enough liquid resources available to meet potential withdrawal demands from their depositors.
7. (B) The ability to accommodate decreases in liability and to fund increases in assets.
Liquidity in banking refers to the fundamental capacity of an institution to meet its financial obligations as they mature. This involves having sufficient funds to handle decreases in liabilities, such as deposit withdrawals, while simultaneously providing resources for asset growth, like new loan disbursements. Effective liquidity management ensures that the bank remains operational without incurring unacceptable losses or costs.
8. (B) Liquidity management responsibility should be decentralised to branch managers without any head office oversight.
A robust structure for managing liquidity risk requires centralized oversight and clearly defined strategies. While branch-level activities contribute to the bank's profile, the overall responsibility

given calendar date from a starting point, usually the next day.

III. Rank cash inflows by the date on which assets mature and outflows by the date liabilities fall due.

- (A) I, II, III
- (B) II, III, I
- (C) III, I, II
- (D) II, I, III

Oct/Nov 2012

77. Consider the following formulas for liquidity stock ratios:

- I. Core deposits / Total Assets
- II. Temporary Assets / Total Assets
- III. Volatile Liabilities / Total Assets
- IV. Temporary Assets / Volatile Liabilities

Which of the above statement(s) is/are correct?

- (A) I, II, and III
- (B) II, III, and IV
- (C) I, II, III, and IV
- (D) I, III, and IV

May/June 2011

78. Effective contingency plans for handling a bank-specific or general market liquidity crisis should address major questions. Which of the following is NOT one of the two major questions explicitly mentioned?

- (A) Does management have a strategy for handling a crisis?
- (B) Does management have procedures in place for accessing cash in emergency?
- (C) Does management have a plan to immediately liquidate the bank's entire physical branch network?
- (D) All of the above are explicitly mentioned.

Oct/Nov 2020

79. Match the Contingency Plan Element (List I) with its specific function or action (List II).

List I: (Contingency Plan Element)

- P. Managerial coordination
- Q. Altering liability behaviour
- R. Managing market access
- S. Public relations management

List II: (Action/Function)

- 1. Avoiding the spread of baseless rumours to prevent retail run-offs
- 2. Setting out a clear division of responsibility for personnel
- 3. Raising deposit rates to retain deposits that

might move elsewhere

4. Exploring arrangements under which a bank can borrow against assets

- (A) P-1, Q-4, R-2, S-3
- (B) P-2, Q-3, R-4, S-1
- (C) P-3, Q-1, R-4, S-2
- (D) P-4, Q-2, R-1, S-3

May/June 2022

80. Assets and liabilities are classified into specific time buckets for liquidity analysis. Which of the following is NOT one of these specified time buckets?

- (A) 21–28 days
- (B) Tomorrow
- (C) Over 5 years
- (D) 8–14 days

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cumulative gap, such as restricting the mismatch between maturing assets and liabilities to a specific percentage of total outflows. These limits help the bank maintain a controlled risk profile and ensure that potential cash shortfalls remain within manageable levels.

18. (A) Statement I is correct and Statement II is incorrect.

Liquidity planning is heavily dependent on monitoring broader economic and money market trends, as these external factors affect all financial institutions. Sound financial management is intended to mitigate negative effects and capitalize on positive trends. Rather than accentuating negative outcomes, effective management provides the tools necessary to navigate volatile market conditions and protect the bank's financial stability and reputation.

19. (D) I, II, and III

Banks with international operations can adopt various structures to manage foreign currency funding. They may choose to centralize all liquidity management at the head office or decentralize responsibility to operating divisions within set limits. Alternatively, they can assign global responsibility for specific currencies to offices in the issuing countries. Each approach offers different levels of control and local market expertise.

20. (A) Setting tolerance level and limit for liquidity risk.

A fundamental step in managing liquidity risk is the establishment of clear tolerance levels and limits. This process allows the bank to define the amount of risk it is willing to accept and provides a framework for monitoring performance. Without these specific parameters, management cannot effectively identify or respond to potential liquidity strains before they become a threat to operations.

21. (C) It indicates a deteriorating liquidity position, as a higher ratio of volatile liabilities signifies potential funding problems.

An increase in the Ratio of Volatile Liabilities to Total Assets typically signals a weakening liquidity profile. Volatile liabilities, such as wholesale market borrowings, are highly sensitive to market conditions and can be withdrawn quickly during

periods of uncertainty. Relying heavily on these sources instead of stable core deposits makes the bank more vulnerable to sudden funding disruptions and increased financing costs.

22. (B) Because the market perceives them as liquid and safe relative to their overall creditworthiness. Financial institutions with strong balance sheets and robust liquidity management systems benefit from favorable market perceptions. Investors and lenders view these banks as safe and capable of meeting their obligations, even during turbulent times. Consequently, these institutions can secure funding at a lower risk premium because the market requires less compensation for the perceived safety of the investment.

23. (D) The risk arising from the need to compensate for non-receipt of expected inflows of funds. Time risk is a specific type of liquidity exposure that occurs when expected cash inflows are delayed or fail to materialize. This often happens when standard loans turn into non-performing assets, disrupting the bank's planned cash flow schedule. To manage this risk, the bank must find alternative funding sources to compensate for the missing inflows and maintain its operational liquidity requirements.

24. (D) I, II, and III

Banks use various limits to manage liquidity, including the loan to deposit ratio and general limits on funding needs versus available sources. They also implement flexible limits on the maturity of different liability categories to ensure a balanced profile. While wholesale funding must be managed carefully, prohibiting it entirely under all circumstances is generally not a standard or practical management requirement.

25. (B) Liquidity importance transcends the individual institution because a single shortfall can have systemic repercussions.

Analyzing liquidity under crisis scenarios is essential because the failure of one bank to meet its obligations can trigger a loss of confidence across the entire financial system. These systemic repercussions mean that liquidity management is a matter of both institutional survival and broader financial stability. Understanding how funding needs evolve during a crisis helps banks prepare contingency plans to mitigate risks.

- 26.** (D) Unmet liquidity needs may force a bank to restructure or acquire high-cost liabilities under adverse market conditions.

Maintaining adequate liquidity is crucial for avoiding the severe consequences of funding shortfalls. If a bank cannot meet its needs through normal channels, it may be compelled to borrow at exorbitant rates or sell assets at significant discounts. Such desperate measures can lead to a formal restructuring or even total failure, highlighting the importance of proactive and robust liquidity management strategies.

- 27.** (A) They must be highly liquid, judged to have a ready market even in periods of stress.

Assets included in liquidity ratio calculations must meet strict criteria for marketability and reliability. These assets must be highly liquid, ensuring they can be converted into cash quickly and at predictable prices, even when the broader market is experiencing significant stress. This ensures the bank has a genuine buffer of available funds to meet sudden and unexpected withdrawal demands.

- 28.** (A) P-2, Q-4, R-3, S-1

Different types of liquidity risk originate from specific drivers within a bank's operations. Funding risk is driven by deposit withdrawals, while time risk stems from non-performing assets affecting expected inflows. Call risk relates to the crystallization of contingent liabilities, and internal liquidity risk is influenced by market perceptions of the institution. Correctly identifying these drivers is essential for developing effective risk mitigation.

- 29.** (C) Converting home currency sources through exchange markets or utilizing pre-arranged back-up foreign currency sources.

A robust back-up liquidity strategy for foreign currency operations focuses on maintaining access to alternative funding channels. If normal foreign funding is disrupted, the bank can utilize pre-arranged back-up facilities or convert domestic currency reserves through the exchange markets. These actions provide a reliable secondary line of defense, ensuring that international operations can continue despite localized or systemic market disruptions.

- 30.** (D) Call Risk

Call risk occurs when contingent liabilities, such as letters of credit or financial guarantees, are unexpectedly converted into actual fund-based obligations. In a market downturn, client defaults can trigger these guarantees, forcing the bank to provide immediate funding. This sudden demand for cash to cover off-balance sheet commitments characterizes call risk and requires the bank to maintain sufficient liquidity reserves to handle drawdowns.

- 31.** (C) Loan maturities as cash inflows in 15 days; drawdowns as cash outflows tomorrow; term deposits as cash outflows in 30 days.

A maturity ladder organizes cash flows based on when they are expected to occur. Maturing loans represent incoming funds, while term deposits falling due are outgoing obligations. Commitment lines that a client can draw upon are treated as potential cash outflows. Correctly categorizing these items allows the bank to identify net funding gaps and manage its liquidity position across different time horizons.

- 32.** (B) I, II, and III

Determining potential assets involves projecting various future cash flows and institutional decisions. Management must estimate the proportion of maturing loans that will be renewed, the volume of new loan requests to be accepted, and the expected drawdowns on existing lending commitments. These factors combined allow the bank to forecast its future asset levels and the corresponding liquidity required to fund them.

- 33.** (B) (Cash + Balances with Central Bank + Government Securities) / Total Assets.

Stock ratios are used to assess the proportion of highly liquid assets held by a bank relative to its total size. A common ratio includes the sum of cash, balances with the central bank, and government securities divided by total assets. This provides a clear measure of the bank's immediate liquidity buffer and its ability to withstand sudden cash outflows.

- 34.** (D) P-2, Q-4, R-3, S-1

In crisis scenarios, different liability categories behave in predictable ways based on their stability and investor type. Retail accounts tend to be more stable due to safety nets, while

wholesale deposits often run off quickly as they are repaid at maturity. Contingent liabilities may see increased drawdowns as market defaults rise. Understanding these behaviors allows banks to construct realistic liquidity stress tests.

- 35.** (A) It assists in managing funding requirements to avoid large needs on specific days and prevent rollover constraints.
The 'General Market Conditions' scenario provides a useful baseline for routine liquidity management. By establishing this benchmark, a bank can identify potential funding gaps and schedule maturities to avoid excessive needs on any single day. This proactive approach helps prevent rollover constraints and ensures the bank can maintain smooth operations under normal, non-stressed market circumstances.
- 36.** (A) It should estimate a significant increase in drawdowns due to rising market defaults and bankruptcies.
During a general market crisis, the behavior of off-balance sheet items often shifts dramatically. As defaults and bankruptcies increase throughout the economy, clients are more likely to utilize their outstanding letters of credit and financial guarantees. Banks must account for this by assuming a significant increase in cash outflows from these contingent liabilities, ensuring they have adequate reserves to meet the demand.
- 37.** (B) The ability to accommodate decreases in liability and to fund increases in assets.
Liquidity represents the vital ability of a financial institution to manage its cash flow obligations effectively. This includes the capacity to meet decreasing liabilities, such as customer withdrawals, and the funding required for increasing assets, like providing new loans. Maintaining this balance is essential for the bank to remain solvent and continue its operations without facing critical financial disruptions or losses.
- 38.** (D) I, II, IV, and V
Constructing a maturity ladder for crisis scenarios requires adjusting normal assumptions about cash flows. Loans that would usually be rolled over may not be, asset sale inflows might decrease, and deposit run-offs often accelerate during bank-specific crises. While the timing of

flows changes, drawdowns on commitments by clients typically increase rather than decrease to zero, as clients seek liquidity for themselves.

- 39.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Different financial institutions may categorize the same asset differently on their maturity ladders based on several internal and external factors. The recognized liquidity of an asset is influenced by the bank's specific asset-liability management policies, the strength of its customer network for asset sales, and unique loan documentation clauses. These institutional differences mean that liquidity is often subjective rather than uniform across the industry.
- 40.** (B) II, III, I
Constructing a maturity ladder follows a logical sequence to accurately measure liquidity. First, every cash inflow and outflow must be allocated to a specific calendar date from a set starting point. Next, these flows are ranked by their respective maturity or due dates. Finally, the bank calculates the excess or deficit of funds as a foundational measure for active liquidity management.
- 41.** (B) Clearing services — Generate significant and predictable cash flows entirely independent of correspondent banks' clearing columns.
Assumptions regarding clearing services are critical because these flows are often highly dependent on external relationships. Rather than being independent, they are closely linked to the clearing columns of correspondent banks. Any disruption in these services or relationships can lead to unpredictable cash flows. Effective management requires an understanding of how these interdependencies affect the bank's overall liquidity and operational cash requirements.
- 42.** (C) The net cash flow, representing the difference between outflows and inflows in future time buckets.
In the flow approach to liquidity management, the 'gap' is a fundamental metric representing net cash flow. It is calculated by determining the difference between total expected cash outflows and inflows within a specific future time bucket. Monitoring these gaps allows the bank to identify

periods of potential shortfall or surplus and take appropriate management actions to ensure continuous liquidity.

43. (B) No longer than four or five weeks.

Active liquidity management primarily focuses on the immediate future to ensure the bank can meet its maturing obligations. While long-term trends are useful for structural planning, the relevant timeframe for day-to-day management of net funding requirements typically extends out to four or five weeks. This short-term focus allows management to respond quickly to market changes and maintain a stable cash flow position.

44. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

A bank-specific crisis scenario assumes the institution faces severe difficulty in maintaining its normal funding operations. Under such stress, a key assumption is that the bank must wind down its books because many liabilities cannot be rolled over or replaced. Consequently, the bank must prepare to repay these obligations at maturity using its own liquid reserves or by selling assets.

45. (C) All these liabilities automatically convert to long-term equity to absorb losses.

In a crisis, wholesale deposits often exhibit volatile behavior, with many being repaid at their earliest possible maturity as funds move to safer assets. While high-quality institutions might see inflows, others face significant run-offs. Importantly, these liabilities are contractual debts and do not automatically convert to equity. Such a conversion would only occur under specific regulatory resolution frameworks, not as a standard crisis behavior.

46. (B) I, II, and III

Liquid or prime assets include resources that can be converted into cash immediately or within a very short timeframe. This category encompasses cash on hand, balances with the central bank, and interbank money at call. Additionally, highly marketable securities held for trading or available for sale are included. These assets provide the essential buffer needed to manage sudden and unexpected cash outflows.

47. (B) Retail depositors rely on the safety net, and switching costs for transaction accounts are prohibitive in the short run.

Retail and small business transaction accounts are generally considered a stable source of funding, even during periods of stress. This stability is driven by depositor reliance on government safety nets, such as deposit insurance, and the high switching costs associated with moving primary banking relationships. Consequently, these deposits are less likely to run off quickly compared to more sensitive wholesale or institutional funds.

48. (B) I, II, and III

A maturity ladder is built by identifying all expected cash movements over specific time periods. Maturing assets and saleable non-maturing assets are recorded as cash inflows, while liabilities falling due represent cash outflows. While drawdowns on credit lines granted to customers are outflows, committed lines of credit available to the bank are sources of potential funding rather than standard ladder inflows.

49. (A) Pledged assets must be deducted from each respective category.

Assets that have been pledged as collateral to third parties are not available for the bank to sell or use to generate liquidity in a crisis. Therefore, in any accurate liquidity analysis, these pledged assets must be deducted from their respective categories. This ensures that the bank's calculated liquidity buffer only includes resources that are truly unencumbered and available for use.

50. (C) Both Statement I and Statement II are correct. The ability to control cash flows through asset sales depends heavily on the nature of the crisis. In a bank-specific scenario, the broader market may still be liquid, allowing the bank to sell assets with little deterioration in capacity. However, during a general market crisis, the overall willingness and ability of institutions to make purchases drops sharply, significantly reducing the marketability of assets.

51. (C) Both Statement I and Statement II are correct. Financial derivatives like swaps and options can create significant unforeseen cash drains during a crisis. If a bank acts as a market-maker, customers

may seek to reduce their credit exposure by requesting the bank to repurchase outstanding instruments. These requests can force the bank to liquidate its own hedges quickly, leading to sudden and potentially large cash outflows that strain liquidity.

52. (D) The bank must manage the shortfall through sources defined in its liquidity policy and strategy. A negative cumulative gap in a specific time bucket indicates a projected funding shortfall. Under the flow approach, the bank is expected to proactively manage this deficit using the sources and methods outlined in its internal liquidity policy. This might involve utilizing back-up credit lines, selling marketable securities, or adjusting its liability structure to ensure that all upcoming obligations are fully met.
53. (C) General Market Conditions, Bank-specific Crisis, and General Market Crisis
Effective liquidity management requires benchmarking against three primary scenarios to understand potential funding needs. These include normal general market conditions, a crisis specific to the individual bank, and a broader crisis affecting the entire market. Analyzing these scenarios allows the bank to develop comprehensive contingency plans and ensure it maintains an adequate liquidity buffer to survive various types of financial stress.
54. (C) Establishing normal levels of deposit roll-overs, the maturity of non-contractual deposits, and the growth in new accounts.
To evaluate cash flows under normal business conditions, a bank must first determine the baseline behavior of its liabilities. This involves analyzing historical data to establish typical deposit roll-over rates and the effective maturity of non-contractual deposits. Additionally, the bank must project the expected growth in new accounts to create an accurate forecast of its routine funding inflows and outflows.
55. (A) High-quality banks may appear liquid in going-concern and market-crisis scenarios, but only marginally so in bank-specific crises. Stylized liquidity graphs reveal how an institution's funding position evolves under different stress levels. Even high-quality banks that appear very liquid during normal operations

or general market disruptions may find their liquidity position severely strained during a bank-specific crisis. This occurs because institutional problems can lead to rapid run-offs of even the most stable funding sources, highlighting the unique dangers of idiosyncratic risk.

56. (A) Contingency planning — Developing assumptions for developing cash flows
The flow approach to liquidity management consists of several core dimensions, including measuring and managing net funding requirements and managing market access. While developing assumptions for cash flows is part of the overall measurement process, it is not the same as contingency planning. Contingency planning is a distinct, broader activity that defines the specific actions management will take when a crisis occurs.
57. (A) I, II, and III
When assessing liability behavior in a crisis, management must identify which funding sources are likely to remain stable and which will run off at varying rates. They must also determine if the bank has reliable back-up facilities to draw upon. While projecting new loan requests is important for normal growth, it is less critical than evaluating the stability of existing funding during an emergency.
58. (A) Established credit lines that can be tapped by the bank
In a maturity ladder, cash outflows include maturing liabilities, interest payments, and expected drawdowns on committed lines granted to customers. Conversely, credit lines that are available for the bank to tap into represent potential sources of cash rather than outflows. These facilities act as a liquidity reserve that the bank can use to meet its obligations when other funding sources are unavailable.
59. (C) Pledged assets are automatically classified as liquid due to the underlying collateral value. Assets are categorized by their relative liquidity, with cash and government securities being the most liquid, while structural assets like premises are the least. Crucially, pledged assets are not liquid because they are encumbered and cannot be sold or used to generate cash during a crisis. Correct classification requires excluding these

flows. “Tomorrow” is the first bucket, followed by “2-7 days” for the upcoming week. The next categories are “8-14 days” and finally “15-30 days.” This chronological ordering allows the bank to monitor its very near-term funding requirements and identify any immediate mismatches that require management action.

structural liquidity frameworks used by banks and regulators. Instead, these days are typically captured within a broader bucket such as “15-30 days.”

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77. (C) I, II, III, and IV

Stock ratios are vital tools for assessing a bank’s structural liquidity position on a given date. These include ratios of core deposits, temporary assets, and volatile liabilities relative to total assets, as well as the relationship between temporary assets and volatile liabilities. Each ratio provides a different perspective on the stability of funding sources and the availability of liquid buffers to meet obligations.

78. (C) Does management have a plan to immediately liquidate the bank’s entire physical branch network?

Effective contingency plans must address whether management has a strategy for handling a crisis and procedures for accessing emergency cash. While selling some assets is common, a plan to liquidate the entire physical branch network is not a standard requirement for liquidity management. Instead, plans focus on maintaining operations through better coordination, altering liability behavior, and managing market access to survive stress.

79. (B) P-2, Q-3, R-4, S-1

Contingency plans consist of various elements designed to manage a crisis effectively. Managerial coordination ensures a clear division of responsibility, while altering liability behavior involves actions like raising deposit rates. Managing market access focuses on exploring borrowing arrangements against assets. Finally, public relations management is used to prevent the spread of rumors and retail run-offs, ensuring a comprehensive institutional response to stress.

80. (A) 21–28 days

Liquidity analysis uses specific time buckets to categorize the maturity of assets and liabilities. Standard buckets include “Tomorrow,” “8-14 days,” and long-term categories like “Over 5 years.” The period “21-28 days” is not a standard, specified bucket in the established

68. (B) I, II, and III

A comprehensive crisis strategy must address multiple operational and strategic areas. It includes establishing clear procedures for timely information flows and defining a precise division of responsibility among personnel. Furthermore, the strategy should outline specific actions to alter asset and liability behaviors, such as slowing down loan growth or raising deposit rates, to improve the bank's overall liquidity position during stress.

69. (D) I, II, III, IV, and V

Numerous factors can influence a bank's liquidity position, ranging from internal financial performance to external economic changes. Declining earnings, rising non-performing assets, and credit rating downgrades all increase liquidity risk. Additionally, even positive developments like expanded business opportunities or new tax initiatives can affect cash flow requirements. Comprehensive risk management requires monitoring all these variables to maintain a stable and robust funding profile.

70. (C) P-3, Q-4, R-1, S-2

Maturity buckets are used to classify assets and liabilities based on their remaining time to maturity. A duration of up to 3 months follows the "Over 2 months" category, while up to 6 months follows the "Over 3 months" bucket. Similarly, up to 1 year follows the "Over 6 months" category, and up to 3 years follows "Over 1 year." This classification helps identify time-specific mismatches.

71. (D) The use of loan-sale clauses in documentation and the frequency of activity in asset-sales markets.

A bank's ability to sell assets quickly during a crisis depends on several practical factors. Indicators of this capacity include the presence of loan-sale clauses in its documentation, which simplifies the legal transfer of assets. Additionally, the frequency of the bank's recent activity in the asset-sales market demonstrates its operational readiness and existing relationships with potential buyers, facilitating faster execution in emergencies.

72. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Public relations management is a critical component of liquidity management during a crisis. Since banking is built on confidence, the spread of unfounded rumors can lead to devastating run-offs by both retail and institutional depositors. By communicating effectively with the media, a bank can provide factual information, reassure the public, and prevent the panic that often worsens a liquidity strain.

73. (B) I, II, III, IV, and V

Liquidity management encompasses several core concepts and risk types that banks must address daily. Funding risk involves unanticipated withdrawals, while time risk relates to delayed inflows, and call risk involves contingent liabilities. Both the stock approach, based on balance sheet levels, and the flow approach, focused on cash movements, are essential for maintaining a safe, Capable, and operational financial institution.

74. (D) Inflows: 220, Outflows: 170, Excess: 50

Calculating the liquidity position requires totaling all cash movements for the day. Total inflows are 220 (150 maturing assets + 50 interest + 20 drawdowns), and total outflows are 170 (100 liabilities + 30 interest + 40 drawdowns). This results in a management excess of 50, providing the bank with a surplus of funds to handle other operational needs or future gaps.

75. (A) To increase cash inflows from asset sales and retain deposits by offering higher rates, thereby slowing run-offs.

During a liquidity deficit, contingency actions are designed to rapidly improve the cash position. Aggressively marketing saleable assets increases immediate cash inflows. Simultaneously, raising deposit rates above market averages encourages existing customers to keep their funds with the bank and attracts new deposits. These combined efforts aim to slow down run-offs and bolster the bank's liquidity buffer to survive the crisis.

76. (A) II, IV, III, I

The standard sequence for short-term liquidity buckets begins with the most immediate cash

assets from the liquidity buffer to maintain a realistic view of available funds.

60. (B) General Market Crisis

A general market crisis is characterized by a systemic shock that impacts all financial institutions simultaneously. During such events, interbank lending typically freezes, and the differences in funding access among institutions widen. While weaker banks face severe liquidity drains, highly reputable institutions may experience a “flight to quality,” receiving unexpected inflows as investors seek safety, illustrating the broad and uneven impact of systemic stress.

61. (C) Both Statement I and Statement II are correct. Maintaining strong customer and lender relationships is vital for navigating a liquidity crisis. During extreme stress, a bank may be forced to prioritize institutional survival over certain customer relationships to preserve cash. However, having established, reliable links with lenders during calm periods provides a critical advantage, as these partners are more likely to provide support when the bank faces an emergency.

62. (A) A lower ‘Net Loans to Total Deposits’ ratio indicates better liquidity, as loans are less liquid than other assets.

Ratio analysis provides essential benchmarks for measuring liquidity risk. A lower Net Loans to Total Deposits ratio is preferred because loans are relatively illiquid, meaning a lower ratio indicates more deposits are available for liquid investments. Conversely, higher ratios for core deposits and liquid assets signal a stronger position, while a higher ratio of market or volatile liabilities indicates increased funding risk.

63. (A) Building relationships with providers through frequent use creates a line of defence against liquidity problems.

Frequently using borrowing arrangements, even when immediate liquidity is not required, is a strategic relationship-building exercise. By maintaining active and routine contact with institutional fund providers, a bank ensures it remains a recognized and trusted participant in the market. These strong on-going links act as a critical line of defense, potentially facilitating

access to funding during sudden and unexpected market disruptions.

64. (A) Over 1 year and up to 2 years

Standard structural liquidity statements categorize assets and liabilities into specific time buckets to identify mismatches. Common short-term buckets include “Tomorrow,” “2-7 days,” and “15-30 days,” while very long-term items are placed in “Over 5 years.” The bucket for “Over 1 year and up to 2 years” is not typically listed as a distinct, standard category in these specific regulatory or management frameworks.

65. (B) The ability to accommodate decreases in liability and to fund increases in assets.

Liquidity in a banking context is the fundamental capacity to fulfill all financial obligations as they become due. This involves having sufficient cash or easily convertible assets to handle decreases in liabilities, such as customer withdrawals, and to provide funding for any increases in assets, such as new loan disbursements. Proper liquidity management ensures the bank remains operational without incurring excessive costs.

66. (B) To offset the upcoming funding gap by influencing the specific maturity of transactions.

Active liquidity management involves taking deliberate steps to address projected funding gaps before they occur. By acquiring an asset that matures on the same day as a significant expected outflow, the bank effectively offsets the requirement. This tactic of influencing the specific maturity of transactions allows the bank to smooth its cash flow profile and reduce the risk of a sudden liquidity shortfall.

67. (C) Utilizing unused credit facilities and drawing upon pre-arranged lines from the domestic central bank.

In an emergency, a bank’s contingency plan focuses on accessing immediate cash to cover shortfalls. Utilizing unused credit facilities and drawing upon pre-arranged lines from the central bank are direct actions to bolster liquidity. These back-up sources provide a vital safety net when normal market funding is unavailable, ensuring the bank can continue to meet its obligations and maintain public confidence.

CHAPTER 30

Interest Rate Risk Management

Oct/Nov 2012

1. Which of the following is an incorrect statement regarding embedded option risk?
 - (A) In cases where there is no penalty for prepayment of loans, borrowers naturally tend to pay off loans when interest rates decline.
 - (B) The faster and higher the magnitude of changes in interest rates, the lower the embedded options risk to the bank's NII.
 - (C) Premature withdrawal of deposits before their stated maturity dates generates embedded option risk.
 - (D) Prepayment of loans leads to lower NII as the bank is forced to reinvest funds at reduced prevailing market rates.

May/June 2011

2. Consider the following elements involved in sound interest rate risk management practices:
 - I. Appropriate board and senior management oversight.
 - II. Adequate risk management policies and procedures.
 - III. Comprehensive internal controls and independent audits.Which of the above statement(s) is/are correct?
 - (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2017

3. Which of the following best defines interest rate risk in the context of banking operations?
 - (A) The exposure of a bank's financial condition to adverse movements in interest rates.
 - (B) The probability of borrower default leading to a write-off of the loan's principal amount.
 - (C) The inability of a bank to generate sufficient cash flows to meet its short-term deposit withdrawal demands.
 - (D) The risk of loss arising from the conversion of foreign currency assets into the domestic

currency.

May/June 2025

4. Which of the following is a correct statement regarding the responsibilities of Senior Management in interest rate risk management?
 - (A) Senior management should operate independently of guidance on acceptable risk levels.
 - (B) Senior management should merge risk measurement and position-taking functions.
 - (C) Senior management relies on external auditors to set standards for valuing positions.
 - (D) Senior management is responsible for maintaining limits and risk measurement systems.

Oct/Nov 2006

5. Regarding the historical transition of interest rate risk management in the banking industry, which of the following statements is incorrect?
 - (A) Deregulation of the financial system has granted operational freedom to financial institutions to price various assets and liabilities based on commercial judgement.
 - (B) Prior to 1970, regulatory restrictions on banks greatly reduced many risks, with deposits taken at mandatory rates and loaned out at legally established rates.
 - (C) Insulating interest spread against frequent interest rate changes has become a major strategic objective of modern bank management.
 - (D) In the 1950s and 60s, banks considered credit, liquidity, and complex interest rate risks as their equal major constraints on profitability.

May/June 2014

6. Which of the following best defines Interest Rate Risk in the Banking Book (IRBBB)?
 - (A) Risk limited to the trading book from short-term movements in equity markets.

NODIA

- (B) Risk of loss due to borrower default on non-performing assets in the book.
- (C) Risk to capital and earnings arising from adverse movements in interest rates.
- (D) Operational risk stemming from inadequate internal systems for processing interest.

Oct/Nov 2019

7. The following question consists of two statements: Assertion (A) and Reason (R). Choose the correct option.

Assertion (A): Mismatching maturities by holding longer-term assets than liabilities exposes a bank to the risk of economic loss when interest rates rise.

Reason (R): When interest rates rise, the market value of longer-term assets falls by a greater amount than the market value of shorter-term liabilities.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2020

8. Match the elements of Enhanced Guidelines on IRRBB in List I to their category in List II.

List I: (Elements of Enhanced Guidelines on IRRBB)

- P. Clearly defined risk appetite statement approved by the Board
- Q. Systems for prompt management attention and escalations
- R. Historical and hypothetical interest rate stress scenarios
- S. Internally selected interest rate shock scenarios addressing the risk profile

List II: (Category)

- 1. Governance
- 2. Governance
- 3. Measurement
- 4. Measurement
- (A) P-1, Q-2, R-3, S-4
- (B) P-3, Q-4, R-1, S-2
- (C) P-1, Q-3, R-2, S-4
- (D) P-4, Q-1, R-3, S-2

Oct/Nov 2008

9. What is the defining characteristic of an “asset sensitive” bank?

- (A) The bank’s assets are repriced much more rapidly than its liabilities during a given period.
- (B) The bank holds a portfolio consisting exclusively of long-term fixed-rate mortgage loans.
- (C) The bank’s liabilities are repriced much more rapidly than its assets during a given period.
- (D) The bank’s asset mix is immune to interest rate fluctuations due to hedging strategies.

May/June 2023

10. Regarding capital requirements for interest rate risk, Basel III Capital regulations (Pillar 2) allow banks to determine the appropriate level of interest rate risk in the banking book. Which factors must a bank keep in view when deciding this level?

- (A) Their historical Tier 1 capital ratios from the preceding five financial years.
- (B) Their capital level, management skills, and ability to re-balance portfolios.
- (C) The volume of Non-Performing Assets located in the trading book exclusively.
- (D) The availability of government-backed synthetic securities in the domestic market.

Oct/Nov 2024

11. Even in a perfectly matched gap position where there is no timing difference between repricing dates, a bank may still experience risk. Which of the following most appropriately identifies this specific risk?

- (A) Basis Risk
- (B) Yield Curve Risk
- (C) Net Interest Position Risk
- (D) Price Risk

May/June 2010

12. When using the Re-pricing Gap methodology, how is a positive gap (Asset Sensitive Gap) mathematically defined?

- (A) $RSA + RSL > 0$
- (B) $RSA - RSL < 0$
- (C) $RSL - RSA > 0$
- (D) $RSA - RSL > 0$

Oct/Nov 2007

13. Beta Bank holds more assets on which it earns interest than liabilities on which it pays interest, resulting in a large positive net interest position. If general market interest rates decline significantly, what is the most likely consequence for Beta Bank?
- The bank will experience an expansion in Net Interest Income.
 - The bank will experience a reduction in Net Interest Income.
 - The bank's net interest position will automatically neutralize to zero.
 - The bank will incur basis risk but maintain a stable Net Interest Income.

May/June 2015

14. A bank's Re-pricing Gap table shows a cumulative gap of Rs. 550 crore for the one-year bucket. If the short-term interest rate increases by 1%, what will be the impact on the Net Interest Income (NII) of the Bank?
- NII will increase by Rs. 5.50 crore.
 - NII will remain unaffected due to the positive gap.
 - NII will reduce by Rs. 5.50 crore.
 - NII will reduce by Rs. 55.0 crore.

Oct/Nov 2018

15. Which of the following is a correct statement regarding Yield Curve Risk?
- It arises exclusively when specific financial assets are sold well before their contractually stated maturity dates.
 - It occurs when volatility in market interest rates prompts the premature withdrawal of fixed-term customer deposits.
 - It is characterized by a balance sheet having more interest-earning assets than interest-paying liabilities.
 - It is triggered by changes in the slope and shape of the yield curve across different maturities.

May/June 2007

16. Consider the following statements regarding the calculation of Modified Duration of Equity:
- Modified Duration of Equity is computed as DGAP multiplied by Leverage.
 - Leverage in this framework is defined as RSA divided by Equity.
 - Equity in this specific calculation context

refers to the total outside liabilities of the bank.

- IV. The drop in equity value due to a rate shock is calculated by multiplying the Modified Duration of Equity by the rate shock percentage.

Which of the above statement(s) is/are correct?

- I, II, and IV only
- I, III, and IV only
- II, III, and IV only
- I, II, and III only

Oct/Nov 2016

17. Which of the following statements accurately summarizes the relationship between bond term lengths and specific types of interest rate risks?
- Short-term bonds have more price risk, while long-term bonds have more reinvestment risk.
 - Short-term bonds have more reinvestment risk, while long-term bonds have more price risk.
 - Both short-term and long-term bonds carry equal levels of reinvestment and price risk.
 - Short-term bonds carry embedded option risk exclusively, while long-term bonds carry only basis risk.

May/June 2022

18. Suppose a bank enters into an Interest Rate Swap where it receives a 5-year fixed rate and pays a floating MIBOR.
- The fixed leg of the swap should be shown as positive in the '5-7 year' bucket.
 - The floating leg would be shown as a negative in the '<1 month' bucket.
 - The notional of both legs must be netted out to zero and excluded from the maturity buckets.

Which of the above statement(s) is/are correct?

- I and II only
- II and III only
- I and III only
- I, II, and III

Oct/Nov 2013

19. Which of the following is an advantage (exception to the limitations) typically associated with standard gap analysis?
- It provides a simple and easily understood overview of the potential mismatch between

(C) II, III, and IV only

(D) I, III, and IV only

May/June 2010

56. Consider the following statements regarding Price Risk:

I. In the financial market, bond prices and bond yields are inversely related.

II. Price risk occurs when assets are held until their stated contractual maturity dates.

Which of the above statement(s) is/are correct?

(A) I only

(B) II only

(C) Both I and II

(D) Neither I nor II

Oct/Nov 2007

57. All derivatives which have a forward component should be considered as a combination of two positions in bonds.

Reason (R): For instance, a long position in a September three month FRA taken on June 1 can be bucketed as a long position with a maturity of six months and a short position with a maturity of three months.

(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

(C) Assertion (A) is true, but Reason (R) is false.

(D) Assertion (A) is false, but Reason (R) is true.

May/June 2015

58. Which of the following is NOT one of the broadly classified sources of interest rate risk?

(A) Embedded Option Risk

(B) Sovereign Default Risk

(C) Reinvestment Risk

(D) Yield Curve Risk

Oct/Nov 2018

59. For bucketing FC-INR options in the Statement of Interest Rate Sensitivity, which value is shown in the respective maturity bucket as an outflow/inflow?

(A) The 'delta' times the notional value amount based on the strike price.

(B) The face value of the option plus the maximum potential premium amount.

(C) The intrinsic value of the option calculated

on the specific day of reporting.

(D) The historical cost of acquiring the option as recorded in the ledger.

May/June 2022

60. Match the following sources of interest rate risk in List I with their descriptions in List II.

List I: (Sources of Interest Rate Risk)

P. Mismatch Risk

Q. Basis Risk

R. Price Risk

S. Embedded Option Risk

List II: (Descriptions)

1. Occurs when assets are sold before their maturity dates, influenced by the inverse relationship of bond prices and yields.

2. Arises from prepayments of loans or premature withdrawal of deposits before stated maturity.

3. Arises from holding assets and liabilities with different principal amounts, maturity dates, or repricing dates.

4. Arises when the interest rates of different assets and liabilities change in different magnitudes during the same period.

(A) P-3, Q-4, R-1, S-2

(B) P-4, Q-3, R-2, S-1

(C) P-2, Q-1, R-4, S-3

(D) P-3, Q-2, R-1, S-4

Oct/Nov 2016

61. The following question consists of two statements: Assertion (A) and Reason (R). Choose the correct option.

Assertion (A): For computing derivatives' duration, cross currency options adopt the same methodology as FC-INR options, using the relevant conversion rate and appropriate yield curve.

Reason (R): Most of the reference and other frequently used rates for such conversions are supplied by specialized financial benchmark providers.

(A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

(B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

(C) Assertion (A) is true, but Reason (R) is false.

(D) Assertion (A) is false, but Reason (R) is true.

(D) Assertion (A) is false, but Reason (R) is true.

May/June 2018

26. Consider the following statements regarding a Forward Rate Agreement (FRA) hedging arrangement where market interest rates increase contrary to expectations:
- The bank deploys funds at the increased market rates, yielding a higher inflow on placement.
 - The bank must pay an increased amount to the FRA counterparty due to the variable payment arrangement.
 - The bank is left unhedged and suffers a net cash outflow.
 - The bank stands fully hedged against interest rate risk, maintaining the same ultimate net cash inflow as in a declining rate scenario.
 - By having entered the FRA, the bank incurs an opportunity loss compared to if it had remained unhedged.
- Which of the above statement(s) is/are correct?
- I, II, III, and V only
 - I, II, IV, and V only
 - II, III, IV, and V only
 - I, III, IV, and V only

Oct/Nov 2011

27. Which interest rate risk measurement technique distributes interest-sensitive assets, liabilities, and off-balance-sheet positions into predefined time bands according to their maturity or time remaining till their next repricing?
- Repricing Schedules
 - Modified Duration
 - Dynamic Simulation
 - Monte Carlo Simulation

May/June 2008

28. Under what conditions do base interest rates for Foreign Currency Non-Resident (FCNR) (B) deposits typically apply?
- They are applicable for all FCNR deposits regardless of the deposit amount.
 - They are applicable exclusively for FCNR deposits of amounts equal to or greater than USD 1 Million.
 - They are applicable only for FCNR deposits of amounts less than USD 1 Million (or equivalent).
 - They apply only to deposits maturing in less

than one year.

Oct/Nov 2025

29. Identify the incorrect pair regarding interest rate risk measurement techniques.
- Gap Analysis — Evaluates earnings exposure by subtracting interest rate-sensitive liabilities from rate-sensitive assets in each time band.
 - Dynamic Simulation — Ignores the behavioral assumptions of the bank's customers to project purely contractual cash flows.
 - Duration — Applies sensitivity weights to each time band based on percentage change in economic value.
 - Static Simulation — Assesses cash flows arising solely from the bank's current on- and off-balance-sheet positions.

May/June 2009

30. Match the term related to Modified Duration calculation in List I with its corresponding mathematical symbol or definition in List II.

List I: (Term)

- Weight (W)
- DGAP
- DA
- DL

List II: (Mathematical Symbol or Definition)

- Rate Sensitive Liabilities / Rate Sensitive Assets
 - Modified DA - $W \times$ Modified DL
 - Weighted average Modified Duration of assets
 - Weighted average Modified Duration of liabilities
- P-1, Q-2, R-3, S-4
 - P-2, Q-1, R-4, S-3
 - P-1, Q-2, R-4, S-3
 - P-4, Q-3, R-2, S-1

Oct/Nov 2010

31. Consider the following statements about the use of "effective duration":
- It better captures the non-linearity of price movements arising from significant changes in market interest rates.
 - It utilizes actual percentage changes in market values of hypothetical instruments resulting from a specific scenario of changing market rates.

Which of the above statement(s) is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

May/June 2024

32. A bank's Re-pricing Gap report shows Rate Sensitive Assets (RSA) of 700 crore and Rate Sensitive Liabilities (RSL) of 800 crore in the >3 months to 6 months bucket. What is the Gap for this specific bucket, and what type of gap does it represent?

- (A) +100 crore; Asset Sensitive Gap
- (B) -100 crore; Asset Sensitive Gap
- (C) +1500 crore; Matched Gap
- (D) -100 crore; Liability Sensitive Gap

Oct/Nov 2009

33. Arrange the following interest rate risk measurement techniques in order of their typical conceptual complexity, from the simplest to the most sophisticated:

- I. Dynamic Simulation
- II. Repricing Schedules
- III. Static Simulation
- IV. Gap Analysis

- (A) II, IV, I, III
- (B) II, IV, III, I
- (C) IV, II, III, I
- (D) IV, III, II, I

May/June 2017

34. A bank has a computed Modified Duration Gap (DGAP) of 0.80 and a Leverage Ratio (RSA / Equity) of 12.00. If the bank anticipates a 200 basis point (2%) rate shock, what is the expected percentage drop in the equity value?

- (A) 9.60%
- (B) 12.80%
- (C) 19.20%
- (D) 24.00%

Oct/Nov 2023

35. To analyze the likely behavior of non-maturity deposits influenced by bank-specific factors and regional market conditions, banks predominantly utilize which of the following approaches?

- (A) Econometric or statistical analysis based on past interest rate movements.
- (B) Strict reliance on original contractual terms

without any tactical deviation.

- (C) Standard duration mapping using sovereign bond yields and government benchmarks.
- (D) Static gap analysis assuming all deposits mature on demand simultaneously.

May/June 2013

36. Match the approach for Modified Duration in List I with the corresponding Balance Sheet / Off-balance Sheet Item in List II.

List I: (Approach for Modified Duration)

- P. Investments
- Q. Assets/liabilities in foreign currency
- R. Forward rate agreements
- S. Interest Rate Futures

List II: (Balance Sheet / Off-balance Sheet Item)

- 1. Treated in a similar manner as a Forward Rate Agreement with the notional shown in relevant buckets.
- 2. Converted into Rupees using relevant spot closing rates.
- 3. Considered as a combination of a short position and long position.
- 4. Compute the actual Modified Duration for each individual item of the portfolio.

- (A) P-4, Q-2, R-3, S-1
- (B) P-1, Q-2, R-4, S-3
- (C) P-4, Q-3, R-2, S-1
- (D) P-2, Q-4, R-1, S-3

Oct/Nov 2022

37. A bank plans to alter its portfolio composition to bridge a negative gap position. Management intends to implement a strategy that specifically reduces liability sensitivity. Which mix of actions would be most appropriate?

- (A) Extend investment portfolio maturities and sell all floating rate loans.
- (B) Increase floating rate deposits and increase short-term borrowings.
- (C) Increase fixed rate lending and increase various short-term borrowings.
- (D) Increase floating rate lending and long-term deposits while reducing maturities.

May/June 2021

38. A bank uses a 91-day 8% term deposit to fund a 5-year fixed rate mortgage loan at 10%. After 91 days, market interest rates have risen sharply. What is the immediate consequence on the bank's Net Interest Income (NII)?

- (A) The bank is asset sensitive; hence NII will

substantially increase over the period.

- (B) The loan will automatically reprice to a higher rate, preserving the overall NII.
- (C) The bank is liability sensitive; hence rising costs will cause erosion in NII.
- (D) The situation represents pure basis risk with no direct impact on the NII volume.

Oct/Nov 2014

39. The following question consists of two statements: Assertion (A) and Reason (R). Choose the correct option.

Assertion (A): Risk-averse bank management will always endeavor for a fully matched book, perfectly aligning the repricing of all assets and liabilities.

Reason (R): Achieving a full match in repricing assets and liabilities is neither feasible nor prudent in practical banking operations.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2005

40. Consider the following statements regarding the interaction between bond pricing, reinvestment risk, and price risk:

- I. The bond pricing formula assumes that all coupon payments are reinvested at the bond's Yield to Maturity (YTM).
- II. When the interest rate goes up, the bond price decreases, but the realized compound yield increases due to higher coupon reinvestment income.
- III. When the interest rate declines, the bond price increases resulting in a capital gain, but realized compound yield decreases because of lower coupon reinvestment income.
- IV. Price risk and reinvestment risk always compound each other, resulting in exponential losses during rate movements.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, and IV only

Oct/Nov 2020

41. Senior management periodically reviews the organization's interest rate risk management reports. To enable management to assess the sensitivity of the institution to market changes accurately, what level of detail should these reports provide?
- (A) Aggregate information as well as sufficient supporting granular details.
 - (B) Only high-level aggregate information to avoid overloading the management with data.
 - (C) Only granular transaction-level details without any aggregation.
 - (D) Exclusively off-balance-sheet exposure summaries.

May/June 2016

42. In the context of banking prior to 1970, the phrase '3-6-3' was a common reference about bankers. What did this phrase signify?
- (A) Maintain 3% capital reserve, lend at 6% margin, and review portfolios every 3 months for compliance.
 - (B) Take deposits at 3%, lend funds at 6%, and finish the working day by 3 p.m.
 - (C) Pay 3% interest on savings, charge 6% on loans, and maintain exactly 3 tiers of senior management.
 - (D) Secure 3-year term deposits, offer 6-year mortgages, and maintain a 3% net interest margin ratio.

Oct/Nov 2008

43. In order to carry out its responsibilities properly, what is a primary function of the board of directors regarding interest rate risk?
- (A) Approving strategies and policies with respect to interest rate risk management.
 - (B) Personally executing daily derivative trades to hedge gaps.
 - (C) Defining the detailed mathematical formulas used in dynamic simulations.
 - (D) Assuming direct operational authority over the position-taking functions of the bank.

May/June 2011

44. Consider the following statements regarding the essential impacts of interest rate risk on a bank:
- I. Changes in interest rates affect a bank's earnings by altering its Net Interest Income (NII).

assets and liabilities.

- (B) It ignores differences in spreads between interest rates that could arise as the level of market interest rates change.
- (C) It fails to account for differences in the sensitivity of income that may arise from option-related positions.
- (D) It generally fails to capture variability in non-interest revenue and expenses.

May/June 2019

20. Which of the following is an incorrect statement regarding the methodology for derivatives and other items under the modified duration approach?
- (A) Interest Rate Futures could be treated in a similar manner as a Forward Rate Agreement.
 - (B) For computing the duration of FC-INR options, the bank may use the MIFOR curve.
 - (C) Banks may aggregate items in groups and take mid-points as the maturity date.
 - (D) Assets and liabilities are converted using the 30-day moving average exchange rate.

Oct/Nov 2005

21. Identify the correct pair regarding the complementary perspectives used for assessing a bank's interest rate risk exposure.
- (A) Earnings Perspective — Focuses on the impact of interest rate changes on the present value of expected net cash flows.
 - (B) Economic Value Perspective — Focuses primarily on the impact of interest rate changes on accrual or reported net interest income.
 - (C) Embedded Losses Perspective — Focuses on future cash flows discounted to reflect current market rates.
 - (D) Earnings Perspective — Focuses on the impact of changes in interest rates on accrual or reported earnings.

May/June 2006

22. Which of the following correctly describes the fundamental mechanics of a Forward Rate Agreement (FRA)?
- (A) It is an exchange-traded contract where the notional principal is physically exchanged.
 - (B) It is a localized agreement requiring the deposit of collateral equal to notional value.
 - (C) It is an OTC contract where payment is

based on the difference between rates.

- (D) It is an option giving the buyer the right to lock in a future interest rate.

Oct/Nov 2015

23. What best defines the economic value of an instrument in the context of interest rate risk?
- (A) The historical cost of the instrument recorded on the balance sheet at the time of origination.
 - (B) The assessment of the present value of its expected net cash flows, discounted to reflect market rates.
 - (C) The future maturity value of the instrument ignoring intermediate coupon payments.
 - (D) The difference between the total interest income and total interest expense generated by the instrument.

May/June 2012

24. To hedge the risk where a bank funds a 3-year deposit with 1-year interbank deployments, what is the most appropriate action?
- (A) Enter into a 1/3 FRA choosing to receive fixed and pay variable, ensuring a fixed rate receivable after one year.
 - (B) Sell the FCNR deposit to a third-party financial institution.
 - (C) Purchase a long-term Treasury Bill equal to three times the deposit amount.
 - (D) Enter into an interest rate swap paying fixed and receiving floating.

Oct/Nov 2021

25. The following question consists of two statements: Assertion (A) and Reason (R). Choose the correct option.
- Assertion (A): Instruments that are not marked to market may already contain embedded gains or losses due to past rate movements.
- Reason (R): A long-term, fixed-rate loan entered into when interest rates were low, and re-funded more recently with liabilities bearing a higher rate of interest, will represent a drain on the bank's resources over its remaining life.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.

- (A) The bank is liability sensitive, and a decline in market interest rates will improve its Net Interest Income.
- (B) The bank has a perfectly matched gap position, completely eliminating interest rate risk.
- (C) The bank is asset sensitive, and a rise in market interest rates will produce a larger Net Interest Income.
- (D) The bank faces pure reinvestment risk with no impact on its immediate Net Interest Income.

Oct/Nov 2019

51. Basel Committee on Banking Supervision (BCBS) finalised standards on IRRBB in April 2016. Which of the following best describes the requirement for banks before full implementation of these standards?
- (A) Banks would continue to follow existing guidelines applicable to the balance sheet.
 - (B) Banks were permitted to suspend all IRR calculations until the implementation date.
 - (C) Banks were mandated to adopt the standardised approach regardless of internal ability.
 - (D) Banks were required to apply the six prescribed shocks to the trading book immediately.

May/June 2020

52. Consider a scenario where a bank has a negative gap of Rs. 10 crore. Market interest rates fall by 1% across the board. However, the rate on call money lending falls by 1.0%, cash credit falls by 0.7%, savings deposits fall by 0.5%, and fixed deposits fall by 0.4%.
- I. Traditional gap management would falsely assume the bank's Net Interest Income should improve by Rs. 1 crore.
 - II. The variation in the magnitude of rate changes causes the basis to move against the bank.
 - III. The bank's Net Interest Income will deteriorate despite the expectation of an improvement under parallel shift assumptions.
 - IV. This situation exemplifies the embedded option risk inherent in composite liability portfolios.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only

- (B) II, III, and IV only
- (C) I, II, and IV only
- (D) I, III, and IV only

Oct/Nov 2017

53. Identify the correct pair regarding the management of a bank's interest-sensitive gap.
- (A) Negative Gap (Refinancing Gap) — Extend the Assets' maturity or shorten the liability maturities.
 - (B) Positive Gap (Re-investment Risk) — Shorten the Assets' maturity or Extend the liability maturities.
 - (C) Negative Gap (Refinancing Gap) — Increase floating rate lending and short-term borrowings.
 - (D) Positive Gap (Re-investment Risk) — Extend the Assets' maturity or shorten the liability maturities.

May/June 2023

54. A bank disburses a 90-day loan at 10% funded by a 90-day Certificate of Deposit at 8%. After 30 days, the market interest rate declines to 9%. The borrower decides to prepay the loan immediately. The bank must now reinvest the funds at 9% for the remaining 60 days. This scenario directly illustrates which type of risk?
- (A) Price Risk
 - (B) Reinvestment Risk
 - (C) Embedded Option Risk
 - (D) Net Interest Position Risk

Oct/Nov 2024

55. Consider the following statements regarding the methodology for computing Modified Duration Gaps:
- I. The mid-point of each time bucket may be taken as a proxy for the maturity of all assets and liabilities in that time bucket.
 - II. The Modified Duration Gap (DGAP) is derived by the equation: $DGAP = \text{Modified DA} - W \times \text{Modified DL}$.
 - III. The weight (W) is calculated as Rate Sensitive Assets divided by Rate Sensitive Liabilities (RSA/RSL).
 - IV. A single yield curve is determined for arriving at yields based on current market yields for each category.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, II, and IV only

May/June 2018

68. Which of the following is NOT an element that an effective interest rate risk measurement system should encompass?
- (A) Assessing all material interest rate risks associated with assets, liabilities, and OBS positions.
 - (B) Utilizing generally accepted financial concepts and standard industry valuation techniques.
 - (C) Having well-documented assumptions and parameters approved by the board of directors.
 - (D) Relying exclusively on end-of-year statutory audit reports for risk quantification.

Oct/Nov 2011

69. The following are considered sources of interest rate risk:
- I. Gap or Mismatch Risk
 - II. Basis Risk
 - III. Net Interest Position Risk
 - IV. Embedded Option Risk
 - V. Price Risk
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, II, III, and IV only
 - (C) II, III, IV, and V only
 - (D) I, II, III, IV, and V

May/June 2008

70. Consider the following statements regarding the Modified Duration concept:
- I. It is a measure of the percentage change in the economic value of a position that will occur given a small change in the level of interest rates.
 - II. Generally, the longer the maturity or next repricing date of the instrument, the higher the duration.
 - III. The smaller the payments that occur before maturity (e.g., coupon payments), the lower the duration.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

Oct/Nov 2025

71. Arrange the following steps for computing the Modified Duration Gap in the correct chronological order:
- I. Generate the bucket-wise cash flows for each item/category.
 - II. Identify variables such as principal amount, maturity date/re-pricing date, coupon rate, and yield.
 - III. Calculate the Modified Duration of each category using the maturity date, yield, and coupon rate.
 - IV. Determine the yield curve for arriving at the yields based on current market yields.
- (A) I, II, IV, III
 - (B) II, I, IV, III
 - (C) II, IV, I, III
 - (D) I, IV, II, III

May/June 2009

72. What defines a “Dynamic Simulation” approach to measuring interest rate risk?
- (A) It involves detailed assumptions about interest rates, business activity, and customer behaviour.
 - (B) It generates a snapshot of the bank’s economic value by applying a standardized 200 basis point shock.
 - (C) It relies on the straight-line depreciation of past non-performing assets to estimate future requirements.
 - (D) It limits analysis to off-balance-sheet positions that may mature within 90 days for management reporting.

Oct/Nov 2010

73. Given the following data for a bank:
- Weighted average Modified Duration of assets (DA) = 2.50
- Weighted average Modified Duration of liabilities (DL) = 1.50
- Weight (W = RSL / RSA) = 1.10
- Using the standard equation, what is the Modified Duration Gap (DGAP)?
- (A) 0.85
 - (B) 1.00
 - (C) 1.65
 - (D) 1.10

May/June 2019

62. When a bank analyzes the variation in its reported earnings due to interest rate fluctuations to ensure its capital adequacy and market confidence are not undermined, which perspective is it primarily utilizing?
- (A) Economic Value Perspective
 - (B) Market Valuation Perspective
 - (C) Earnings Perspective
 - (D) Liquidation Perspective

Oct/Nov 2005

63. A bank accepts an FCNR deposit for 3 years at 1.45% p.a. and deploys the funds in the interbank market at 1.50% for one year. What is the primary risk the bank faces after the first year?
- (A) The risk that interbank market rates will rise, causing a significant liquidity shortfall.
 - (B) The risk that the bank's own credit rating will be downgraded by international agencies.
 - (C) The risk that the FCNR depositor will prematurely withdraw funds before the maturity date.
 - (D) The risk that market interest rates will decline, forcing the deployment at lower yields.

May/June 2006

64. Consider the following statements regarding the advantages of Economic Value Added (EVA):
- I. EVA complements financial data from various other methods of business valuation and assessment.
 - II. It illustrates working capital availability after the deduction of actual opportunity cost.
 - III. It can precisely calculate the return on expenses like research and development.
 - IV. It is used as a management incentive that ensures a company's continuity of operations.
 - V. It helps to escape from problems related to percentage calculations by making use of specific values.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV only
 - (B) I, II, IV, and V only
 - (C) II, III, IV, and V only
 - (D) I, III, IV, and V only

Oct/Nov 2015

65. Consider the following statements regarding a Forward Rate Agreement (FRA) hedging arrangement where market interest rates decline as anticipated:
- I. The bank receives a fixed amount under the FRA while it pays whatever it receives on placement based on the floating rate.
 - II. The combination of the placement inflow and FRA inflow perfectly offsets the decline, leaving the bank hedged with a positive ultimate cash inflow.
- Which of the above statement(s) is/are correct?
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

May/June 2012

66. Before risk can be managed, it must be identified and quantified. Which of the following should measurement systems utilize to identify and quantify risk?
- (A) Solely historical cost accounting principles and internal bookkeeping records.
 - (B) Only static simulations that strictly avoid all forms of dynamic modelling.
 - (C) Generally accepted financial concepts and risk measurement techniques.
 - (D) Exclusively external credit rating agency methodologies and public scoring.

Oct/Nov 2021

67. Consider the following statements regarding interest rates on FCNR (B) deposits:
- I. In view of the discontinuance of LIBOR, banks are permitted to offer interest rates using the Overnight Alternative Reference Rate (ARR).
 - II. Regulatory authorities have permitted an upward revision in the interest rates ceiling by 50 bps for the respective currency.
 - III. Base rates for FCNR deposits are provided by authorized foreign exchange dealer association websites.
- Which of the above statement(s) is/are correct?
- (A) I and II only
 - (B) II and III only
 - (C) I and III only
 - (D) I, II, and III

- II. Changes in interest rates affect the underlying value of the bank's off-balance-sheet instruments.
- III. The market value of an asset or liability is independent of the present value of future cash flows.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

Oct/Nov 2023

45. To avoid potential conflicts of interest, how should banks structure their lines of responsibility and authority for managing interest rate risk?

- (A) Risk measurement, monitoring, and control functions should be heavily integrated with the position-taking functions.
- (B) Risk measurement and monitoring functions should be sufficiently independent from position-taking functions.
- (C) The board of directors should directly administer daily monitoring without a designated independent unit.
- (D) Position-taking units should report their own risk exposures directly to external regulators.

May/June 2007

46. Which of the following statements correctly describes the relationship between market value and interest rates?

- (A) Falling interest rates increase the discount rate on future cash flows, thereby increasing the market value of the asset or liability.
- (B) Rising interest rates decrease the discount rate on future cash flows, thereby decreasing the market value of the asset or liability.
- (C) Rising interest rates increase the discount rate on future cash flows, thereby decreasing the market value of the asset or liability.
- (D) Falling interest rates decrease the discount rate on future cash flows, thereby decreasing the market value of the asset or liability.

Oct/Nov 2012

47. Consider the following statements regarding the Asset Liability Management System concerning Non Maturity Deposits (NMDs):

- I. Banks are required to estimate behavioural

patterns of NMDs and place them into appropriate time buckets.

- II. Banks which are not able to estimate these behavioural patterns are required to follow the internal simulation approach.

Which of the above statement(s) is/are correct?

- (A) I only
- (B) II only
- (C) Both I and II
- (D) Neither I nor II

May/June 2025

48. A financial institution funds assets of Rs. 100 crore, which yield 10% and mature in two years, using Rs. 100 crore in liabilities at 9% that mature in one year. Over the first year, the bank earns a profit spread of 1%. If the interest rate on the liabilities increases to 11% in the second year, what is the impact on the bank's position?

- (A) The bank will maintain its 1% profit spread as the asset yield will automatically adjust.
- (B) The bank will secure a 2% profit spread due to the extended maturity of the assets.
- (C) The bank will experience a neutral financial effect because the principal amounts match.
- (D) The bank will incur a net loss of 1% (Rs. 1 crore) in the second year.

Oct/Nov 2006

49. Under the Enhanced Guidelines on IRRBB, banks should compute the IRRBB and its impact on economic value and earnings based on certain scenarios. Which of the following is NOT one of those stipulated bases?

- (A) Internally selected interest rate shock scenarios according to the ICAAP policy.
- (B) Exclusively flat-rate statutory adjustments dictated by local municipal authorities.
- (C) Historical and hypothetical interest rate stress scenarios tending to be more severe than ordinary shocks.
- (D) The six prescribed interest rate shock scenarios.

May/June 2014

50. Alpha Bank invests the proceeds of a 91-day 8% deposit into a floating rate loan repriced at monthly intervals with an initial rate of 10%. Over the 91 days, the deposit rate remains unchanged, while the loan rate is updated twice. In this scenario, what characterizes the bank's exposure?

May/June 2024

- 74.** Consider the following statements regarding interest rate risk measurement (behavioral vs. contractual maturity):
- Mortgages can be subject to prepayment, creating uncertainty about the timing of cash flows.
 - Decline in interest rates generally results in decreasing levels of prepayments as borrowers avoid refinancing.
 - Non-maturity deposits can often be withdrawn without penalty at the depositor's discretion.
 - Rates received by depositors on non-maturity deposits tend to move in close correlation with changes in general market interest rates.
- Which of the above statement(s) is/are correct?
- I and II only
 - I and III only
 - II and IV only
 - III and IV only

Oct/Nov 2009

- 75.** A bank buys a USD 20 million long call Rupee dollar option against INR at a strike price of Rs. 80.00. The delta of this option is 0.50. For the purpose of bucketing in the Statement of Interest Rate Sensitivity, what is the outflow amount to be recorded?
- Rs. 80.00 crore
 - Rs. 40.00 crore
 - Rs. 160.00 crore
 - Rs. 20.00 crore

May/June 2017

- 76.** Which of the following is an incorrect statement regarding the limitations of the standard duration approach?
- It generally focuses on just one form of interest rate risk exposure, which is repricing risk.
 - It uses an average duration for each time band, ignoring differences in the actual sensitivity of positions.
 - It effectively captures interest rate risk arising from changes in the relationship among interest rates.
 - It uses simplifying assumptions which mean the risk of options may not be adequately captured.

Oct/Nov 2013

- 77.** Identify the incorrect pair linking a strategy to its resulting impact on interest rate sensitivity.
- Extend investment portfolio maturities — Reduces Asset Sensitivity
 - Increase fixed rate lending — Reduces Liability Sensitivity
 - Increase floating rate deposits — Reduces Asset Sensitivity
 - Increase long-term deposits — Reduces Liability Sensitivity

May/June 2013

- 78.** Match the risk management tools/strategies in List I with their specific intended actions or outcomes in List II.

List I: (Risk Management Tools/Strategies)

- Use of Swaps and Financial Futures
- Reducing investment portfolio maturities
- Extending investment portfolio maturities
- Fixing appropriate tolerance limits on gaps

List II: (Intended Actions or Outcomes)

- Strategy used to reduce liability sensitivity.
 - Strategy used to reduce asset sensitivity.
 - Method to construct synthetic securities to hedge against exposure.
 - Action to minimize adverse impact on NII due to inevitable mismatches.
- P-3, Q-1, R-2, S-4
 - P-4, Q-2, R-1, S-3
 - P-1, Q-3, R-4, S-2
 - P-3, Q-2, R-1, S-4

Oct/Nov 2022

- 79.** XYZ Bank issues a zero-coupon deposit of Rs. 10,000 promising to double the amount in 7 years. It invests the funds in a 7-year bond with an annual coupon of 12%. If interest rates fall to 10% after one year, what specific problem does the bank encounter?
- The bank faces price risk because the market value of the 7-year bond drops significantly.
 - The bank faces embedded option risk as the depositor is guaranteed to withdraw the deposit.
 - The bank faces basis risk because the zero-coupon rate fluctuates randomly during the term.
 - The bank faces reinvestment risk because it can only reinvest the coupons at lower yields.

NODIA

May/June 2021

- 80.** An effective system of internal control for interest rate risk includes several key elements. Which of the following is NOT one of these elements?
- (A) A strong control environment and compliance culture.
 - (B) Establishment of activities like policies and procedures.
 - (C) Continual review of adherence to established protocols.
 - (D) Outsourcing the risk identification to third-party firms.

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ANSWERS

1. (B) The faster and higher the magnitude of changes in interest rates, the lower the embedded options risk to the bank's NII.
Embedded options give customers the right to alter cash flows. When interest rates change significantly or rapidly, the likelihood of customers exercising these options increases. Borrowers prepay loans when rates fall to refinance cheaply, while depositors withdraw early when rates rise to seek better yields. Consequently, larger interest rate movements actually increase embedded option risk for banks.
2. (D) I, II, and III
Robust interest rate risk management requires a multi-layered approach. Board and senior management oversight ensures strategic alignment and risk appetite. Clear policies and procedures provide operational frameworks for daily activities. Finally, comprehensive internal controls and independent audits verify compliance and the accuracy of risk measurement systems, ensuring the entire banking organization remains resilient against market fluctuations.
3. (A) The exposure of a bank's financial condition to adverse movements in interest rates.
Interest rate risk represents the potential for a bank's financial condition to deteriorate due to fluctuations in market interest rates. This risk affects both the earnings, through net interest income volatility, and the economic value of assets, liabilities, and off-balance-sheet instruments. Effective management involves identifying how these movements impact the overall stability and profitability of the institution.
4. (D) Senior management is responsible for maintaining limits and risk measurement systems.
Senior management plays a critical role in the operational aspects of risk management. They are responsible for implementing the board's strategies by establishing and maintaining rigorous risk measurement systems. Additionally, they must enforce internal limits and ensure that the bank's exposure remains within the approved risk appetite while providing clear guidance to staff regarding acceptable risk levels.
5. (D) In the 1950s and 60s, banks considered credit, liquidity, and complex interest rate risks as their equal major constraints on profitability.
Before the 1970s, the banking environment was highly regulated with fixed interest rates on deposits and loans. This stability meant that interest rate risk was minimal. During the 1950s and 1960s, banks primarily focused on credit and liquidity risks. Complex interest rate risk only became a major strategic constraint following financial deregulation and increased market volatility later.
6. (C) Risk to capital and earnings arising from adverse movements in interest rates.
Interest Rate Risk in the Banking Book refers to the current or prospective risk to a bank's capital and earnings arising from adverse movements in interest rates. This risk specifically impacts the banking book, which includes non-trading assets and liabilities. It encompasses mismatch risk, basis risk, yield curve risk, and the effects of embedded customer options.
7. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
Holding long-term assets funded by short-term liabilities creates a maturity mismatch. When market interest rates rise, the present value of all future cash flows is discounted at a higher rate. Long-term instruments have higher duration and are more sensitive to these changes than short-term ones. Therefore, the value of long-term assets declines more significantly, leading to economic losses.
8. (A) P-1, Q-2, R-3, S-4
Enhanced guidelines categorize risk management components systematically. Governance includes high-level strategic elements like board-approved risk appetite statements and escalation procedures for prompt management attention.

requiring conversion rates and appropriate yield curves. While benchmark providers supply the necessary market rates for these conversions, this fact describes a data source rather than explaining the fundamental methodology of bucketing. Both statements are accurate regarding the operational process of valuing these derivatives for interest rate risk monitoring.

62. (C) Earnings Perspective

The earnings perspective focuses on the impact of interest rate changes on a bank's accrual-based financial results. It specifically analyzes how fluctuations in rates will alter the reported net interest income and overall profitability. By monitoring this variation, banks ensure that their earnings remain stable enough to maintain capital adequacy and preserve the confidence of investors and the broader market.

63. (D) The risk that market interest rates will decline, forcing the deployment at lower yields.
The bank has a 3-year fixed-rate liability (FCNR deposit) but has deployed the funds in a 1-year interbank instrument. This creates a mismatch after the first year. If market interest rates decline during that period, the bank will be forced to reinvest the principal from the maturing interbank deployment at lower prevailing yields while its funding cost remains fixed at 1.45%.

64. (B) I, II, IV, and V only

Economic Value Added offers several management advantages. It complements other valuation methods and shows the capital available after accounting for opportunity costs. It also serves as an effective management incentive. Furthermore, EVA uses specific values instead of percentages, which helps clarify the absolute financial impact of business decisions. However, it cannot precisely calculate the exact returns on qualitative research expenses.

65. (C) Both I and II

When a bank enters an FRA to hedge against falling rates and rates actually decline, the hedge functions as intended. The bank receives a fixed payment from the FRA counterparty, which compensates for the lower interest earned on its floating-rate placements. The combination of these two cash flows ensures that the bank

achieves its target net interest income regardless of the decline.

66. (C) Generally accepted financial concepts and risk measurement techniques.

For a bank to effectively manage interest rate risk, it must first accurately identify and quantify its exposure. Measurement systems should be based on generally accepted financial concepts and utilize standardized risk measurement techniques. This approach ensures that the data produced is reliable, comparable across different institutions, and provides a sound basis for senior management to make informed strategic risk decisions.

67. (D) I, II, and III

Following the discontinuance of LIBOR, banks are authorized to use the Overnight Alternative Reference Rate for FCNR (B) deposits. Regulatory updates have also allowed for a 50 basis point increase in the interest rate ceiling for these deposits. The necessary base rates for calculating these ceilings are provided on the websites of authorized foreign exchange dealer associations to ensure transparency.

68. (D) Relying exclusively on end-of-year statutory audit reports for risk quantification.

An effective interest rate risk measurement system must proactively assess all material risks from assets, liabilities, and off-balance-sheet positions. It should use well-documented assumptions approved by the board and utilize standardized valuation techniques. Relying solely on year-end statutory audit reports is insufficient because risk management requires frequent, timely data to respond to dynamic market conditions and ensure ongoing institutional stability.

69. (D) I, II, III, IV, and V

Interest rate risk in a bank originates from multiple sources. These include mismatch risk between assets and liabilities, basis risk from different benchmark indices, and net interest position risk. Additionally, embedded option risk arises from customer behavioral choices, while price risk reflects the sensitivity of market values to rate changes. A comprehensive risk management framework must address each of these sources.

leads to greater price risk, where the market value fluctuates significantly as interest rates rise or fall.

18. (A) I and II only

Interest Rate Swaps are bucketed based on the repricing characteristics of their individual legs. The fixed-rate leg is treated like a fixed-rate bond and placed in the maturity bucket corresponding to its remaining term. The floating-rate leg is treated as a short-term instrument, typically placed in the bucket representing the time remaining until the next reset date, such as MIBOR.

19. (A) It provides a simple and easily understood overview of the potential mismatch between assets and liabilities.

Standard gap analysis is a widely used technique because it provides a straightforward and easily understood summary of the potential repricing mismatches between assets and liabilities. It helps management quickly identify the direction of the bank's interest rate sensitivity. While it has limitations regarding basis risk and options, its simplicity makes it an effective tool for high-level risk assessment.

20. (D) Assets and liabilities are converted using the 30-day moving average exchange rate.

For interest rate risk measurement, assets and liabilities denominated in foreign currencies must be converted into the reporting currency. However, the standard methodology requires using relevant spot closing exchange rates on the reporting date rather than a moving average. This ensures that the risk assessment reflects the current economic value and market conditions at the time of the reporting.

21. (D) Earnings Perspective — Focuses on the impact of changes in interest rates on accrual or reported earnings.

The earnings perspective focuses on how interest rate fluctuations impact a bank's reported net interest income and net income over a shorter horizon. It emphasizes the accrual-based results often found in financial statements. In contrast, the economic value perspective looks at the impact on the present value of all future cash flows, providing a long-term view of total wealth.

22. (C) It is an OTC contract where payment is based on the difference between rates.

A Forward Rate Agreement is a customized over-the-counter derivative contract between two parties. It allows them to lock in an interest rate for a future period starting at a specific date. No principal is exchanged; instead, the parties settle the difference between the agreed contract rate and the prevailing market reference rate at the start of the contract period.

23. (B) The assessment of the present value of its expected net cash flows, discounted to reflect market rates.

Economic value represents the theoretical market worth of a financial instrument. It is determined by calculating the present value of all its expected future cash flows, including principal and interest. These cash flows are discounted using a rate that reflects current market conditions. This perspective provides a comprehensive view of how interest rate changes affect the bank's long-term financial health.

24. (A) Enter into a 1/3 FRA choosing to receive fixed and pay variable, ensuring a fixed rate receivable after one year.

The bank faces the risk that interest rates will fall after one year, reducing the income from its interbank deployments while the 3-year deposit cost remains fixed. To hedge this, the bank can enter a 1/3 Forward Rate Agreement to receive a fixed rate. This ensures it secures a known interest level for the period starting one year from now.

25. (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Instruments not marked to market may hide economic gains or losses caused by past rate movements. For instance, a fixed-rate loan issued during a low-rate environment becomes less valuable if funded by newer, high-cost liabilities. While the example illustrates how specific mismatches drain resources, it describes a consequence of repricing rather than directly explaining why historical accounting hides gains.

26. (B) I, II, IV, and V only

If a bank enters an FRA to hedge falling rates but rates rise instead, it will earn more on its

Measurement involves technical processes such as analyzing historical and hypothetical stress scenarios. Internally selected shock scenarios also fall under measurement, as they help quantify potential impacts on the bank's specific financial profile and risk.

9. (A) The bank's assets are repriced much more rapidly than its liabilities during a given period. An asset-sensitive bank is characterized by having more rate-sensitive assets than rate-sensitive liabilities within a specific time frame. This means the bank's interest-earning assets will reprice faster than its interest-paying liabilities when market rates change. Consequently, if interest rates rise, the interest income increases more than the interest expense, leading to an expansion in net interest income.

10. (B) Their capital level, management skills, and ability to re-balance portfolios. Under Basel III Pillar 2, banks must maintain capital commensurate with their risk profile. When determining the appropriate level of interest rate risk, institutions must evaluate their available capital buffers and the expertise of their management team. They also need to assess their operational ability to re-balance portfolios effectively in response to shifting market conditions and risks.

11. (A) Basis Risk

Basis risk arises when the interest rates on various assets and liabilities are linked to different benchmarks. Even if repricing dates are perfectly matched, the underlying indices, such as MIBOR or Treasury Bill rates, may not move in perfect correlation. This discrepancy in the magnitude of rate changes across different instruments can lead to fluctuations in net interest income.

12. (D) $RSA - RSL > 0$

The repricing gap is calculated by subtracting rate-sensitive liabilities from rate-sensitive assets for a specific time period. A positive gap, also known as an asset-sensitive position, occurs when the value of assets repricing exceeds the value of liabilities repricing. In this scenario, the bank's net interest income typically increases if interest rates rise and decreases if they fall.

13. (B) The bank will experience a reduction in Net Interest Income.

A large positive net interest position indicates that interest-earning assets exceed interest-paying liabilities. When general market interest rates decline, the total income generated from these assets falls by a larger absolute amount than the savings achieved from lower interest expenses on liabilities. This imbalance leads to a contraction of the bank's net interest income and overall profitability for the period.

14. (A) NII will increase by Rs. 5.50 crore.

Net Interest Income impact is determined by multiplying the cumulative repricing gap by the change in interest rates. A positive gap of Rs. 550 crore indicates an asset-sensitive position. When rates increase by 1%, the additional income from assets repricing upward exceeds the additional cost of liabilities. Specifically, 1% of Rs. 550 crore results in a Rs. 5.50 crore increase.

15. (D) It is triggered by changes in the slope and shape of the yield curve across different maturities.

Yield curve risk is a source of interest rate risk that arises from non-parallel shifts in the yield curve. It occurs when the relationship between interest rates of different maturities changes, affecting the slope or shape of the curve. These variations impact the relative values and income generated from assets and liabilities that reprice at different points in time.

16. (A) I, II, and IV only

Modified Duration of Equity measures the sensitivity of a bank's net worth to interest rate shocks. It is calculated by multiplying the duration gap by the leverage ratio. In this context, leverage is defined as rate-sensitive assets divided by equity. The total estimated drop in equity value is then found by multiplying this duration measure by the rate change percentage.

17. (B) Short-term bonds have more reinvestment risk, while long-term bonds have more price risk. Short-term bonds face higher reinvestment risk because the principal must be redeployed more frequently, potentially at lower future rates. Conversely, long-term bonds are more sensitive to interest rate changes because their cash flows are further in the future. This higher duration

- 35.** (A) Econometric or statistical analysis based on past interest rate movements.
Non-maturity deposits, such as savings and current accounts, lack a fixed repricing date or maturity. To manage the interest rate risk associated with these funds, banks use econometric or statistical analysis. These models evaluate historical data to identify patterns in deposit stability and sensitivity to rate changes, allowing banks to assign behavioral maturities to these balances for accurate measurement.
- 36.** (A) P-4, Q-2, R-3, S-1
Different instruments require specific duration treatments. For investments, actual modified duration should be computed for each item. Foreign currency items are converted to local currency using spot closing rates. Forward Rate Agreements are treated as combinations of short and long bond positions. Finally, interest rate futures are handled similarly to FRAs, with their notional values placed in the appropriate maturity buckets.
- 37.** (D) Increase floating rate lending and long-term deposits while reducing maturities.
To reduce liability sensitivity, a bank aims to decrease the amount of liabilities repricing soon while increasing assets that reprice quickly. This is achieved by shifting toward floating-rate lending, which allows interest income to rise with market rates. Simultaneously, attracting more long-term fixed-rate deposits locks in costs and reduces the volume of liabilities that must be repriced in the near future.
- 38.** (B) II, I, IV, III
In this scenario, the bank is liability sensitive because its funding source reprices in 91 days while its asset yield is fixed for five years. If market interest rates rise, the bank will be forced to pay a higher rate on the deposit upon renewal. Since the income from the mortgage remains unchanged, the increased interest expense will erode the NII.
- 39.** (D) Assertion (A) is false, but Reason (R) is true.
While risk-averse management seeks to minimize exposure, it is practically impossible and often undesirable to maintain a perfectly matched book. Banking inherently involves taking risks to generate profit, and customer preferences often

create natural mismatches. Attempting to match all repricing exactly would severely limit a bank's ability to serve its customers and capitalize on market opportunities for generating interest income.

- 40.** (A) I, II, and III only
Bond pricing formulas assume reinvestment at the yield to maturity. When interest rates rise, bond prices fall, creating capital losses. However, the income from reinvested coupons increases, potentially offsetting some losses. Conversely, falling rates increase bond prices but reduce the yield from reinvested coupons. These risks do not always compound each other; instead, they often act as offsetting forces over time.
- 41.** (A) Aggregate information as well as sufficient supporting granular details.
To effectively manage interest rate risk, senior management requires reports that offer both high-level summaries and underlying detail. Aggregate data allows for a quick assessment of the bank's overall risk profile and compliance with limits. Granular details are necessary to identify the specific sources of risk and to understand how different business units or portfolios contribute to the total exposure.
- 42.** (B) Take deposits at 3%, lend funds at 6%, and finish the working day by 3 p.m.
The phrase '3-6-3' describes the relatively stable and less competitive banking environment that existed before the financial deregulations of the 1970s. Bankers would pay three percent interest on deposits, charge six percent interest on loans, and were often able to finish their workday by three in the afternoon. This era was characterized by minimal interest rate volatility and risk.
- 43.** (A) Approving strategies and policies with respect to interest rate risk management.
The primary responsibility of the board of directors in interest rate risk management is to set the overall strategic direction. They must approve the bank's risk appetite, management strategies, and governing policies. While they oversee the risk management framework, they do not participate in daily trading or technical calculations, which are handled by senior management and specialized risk management units.

actual placements. However, this gain is offset by a settlement payment to the FRA counterparty. While the bank remains fully hedged at the target rate, it incurs an opportunity loss by missing out on the higher unhedged market returns.

27. (A) Repricing Schedules

Repricing schedules, often used in gap analysis, involve organizing interest-sensitive assets, liabilities, and off-balance-sheet positions into specific time buckets. These buckets are determined based on the time remaining until the next interest rate reset or contractual maturity. This method allows banks to identify and quantify timing mismatches and assess the impact of interest rate changes on net interest income.

28. (C) They are applicable only for FCNR deposits of amounts less than USD 1 Million (or equivalent). Regulatory guidelines specify how interest rates are established for Foreign Currency Non-Resident (B) deposits. For deposit amounts that are less than USD 1 Million, or the equivalent in other currencies, banks typically apply base interest rates. These rates are often linked to benchmarks such as the Overnight Alternative Reference Rate to ensure transparency and consistency across the banking industry's offerings.

29. (B) Dynamic Simulation — Ignores the behavioral assumptions of the bank's customers to project purely contractual cash flows. Dynamic simulation is a sophisticated interest rate risk measurement technique that explicitly includes behavioral assumptions. Unlike static models, it incorporates predictions about customer prepayments, deposit withdrawals, and new business growth under various interest rate scenarios. By accounting for these factors, dynamic simulation provides a more realistic and forward-looking projection of a bank's future earnings and economic value under changing conditions.

30. (A) P-1, Q-2, R-3, S-4

In duration analysis, specific terms define the mathematical relationship between assets and liabilities. The weight factor is the ratio of rate-sensitive liabilities to rate-sensitive assets. The weighted average modified durations of

assets and liabilities are denoted as DA and DL, respectively. Finally, the modified duration gap is calculated by subtracting the weighted duration of liabilities from the modified duration of assets.

31. (C) Both I and II

Effective duration is a refined measurement tool used to capture the non-linear relationship between interest rate changes and instrument prices. It is particularly useful for analyzing significant market movements. By using actual percentage changes in market values derived from specific rate scenarios, it provides a more accurate reflection of risk than simple modified duration, which assumes a linear price-yield relationship.

32. (D) -100 crore; Liability Sensitive Gap

The repricing gap is calculated as rate-sensitive assets minus rate-sensitive liabilities. With RSA at 700 crore and RSL at 800 crore, the result is a negative gap of 100 crore. A negative gap indicates that the bank is liability-sensitive, meaning more liabilities than assets are repricing in that period. This exposes the bank to potential losses if interest rates rise.

33. (B) II, IV, III, I

Interest rate risk measurement techniques vary in complexity. Repricing schedules are the most basic, followed by gap analysis which uses those schedules. Static simulation adds more detail by projecting cash flows from existing positions. Dynamic simulation is the most sophisticated, as it incorporates complex assumptions about future business activities, customer behavior, and varied interest rate paths to model future financial outcomes.

34. (C) 19.20%

The percentage change in equity value is calculated by multiplying the Modified Duration of Equity by the interest rate shock. First, find the Modified Duration of Equity by multiplying the DGAP (0.80) by the Leverage Ratio (12.00), which equals 9.60. Multiplying this result by a 200 basis point (2%) rate shock results in an expected equity value drop of 19.20%.

liability rates, the interest spread actually narrows. This variation in rate changes demonstrates basis risk, where the bank's NII deteriorates despite the falling rate environment typically favorable for liability-sensitive institutions.

- 53.** (D) Positive Gap (Re-investment Risk) — Extend the Assets' maturity or shorten the liability maturities.

A positive gap represents reinvestment risk, where assets reprice faster than liabilities. To manage this, a bank can extend asset maturities to lock in yields for longer or shorten liability maturities to take advantage of falling rates. Conversely, managing a negative gap, or refinancing risk, involves shortening asset maturities or extending liability maturities to protect against rising interest rate costs.

- 54.** (C) Embedded Option Risk

Embedded option risk arises when customers have the right to alter the timing of cash flows. In this case, the borrower exercises a prepayment option when market rates fall. The bank is forced to reinvest the returned principal at a lower rate (9%) instead of the original 10%. This illustrates how customer-driven options can adversely impact a bank's net interest income.

- 55.** (B) I, II, and IV only

To compute the Modified Duration Gap, banks use the mid-point of each time bucket as a proxy for maturity. The gap is calculated using the standard formula involving asset and liability durations. A single yield curve based on market yields is used for all categories. However, the weight (W) is correctly defined as rate-sensitive liabilities divided by rate-sensitive assets.

- 56.** (A) I only

Price risk is the potential for loss in the market value of a financial instrument due to fluctuations in interest rates. Bond prices and yields have an inverse relationship; prices fall as yields rise. This risk specifically occurs when assets are sold before their contractual maturity dates. If held until maturity, the investor receives the full face value, eliminating price risk.

- 57.** (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).

Derivatives with a forward component, like Forward Rate Agreements, are modeled as a combination of long and short bond positions. For example, a three-month FRA starting in three months is bucketed as a six-month long bond and a three-month short bond. This approach captures the specific repricing and maturity risks inherent in the contract's forward-looking interest rate commitments and exposures.

- 58.** (B) Sovereign Default Risk

Interest rate risk is primarily categorized into mismatch risk, basis risk, yield curve risk, and embedded option risk. Reinvestment risk and price risk are also significant components related to how rate changes affect cash flows and market values. Sovereign default risk, however, is a form of credit risk related to the possibility of a national government failing to meet its obligations.

- 59.** (A) The 'delta' times the notional value amount based on the strike price.

When reporting FC-INR options in the Statement of Interest Rate Sensitivity, banks use the delta-equivalent approach. The amount recorded in the relevant maturity bucket as an inflow or outflow is the delta of the option multiplied by its notional value. This method accurately reflects the option's sensitivity to small changes in interest rates, providing a better measure of actual risk exposure.

- 60.** (A) P-3, Q-4, R-1, S-2

Mismatch risk arises from different repricing dates between assets and liabilities. Basis risk occurs when benchmark rates for various instruments change by different magnitudes. Price risk involves losses when assets are sold before maturity as market yields rise. Finally, embedded option risk is triggered by customer actions, such as loan prepayments or early deposit withdrawals, in response to changing interest rate environments.

- 61.** (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).

Cross-currency options are treated similarly to FC-INR options for duration calculations,

44. (A) I and II only

Interest rate fluctuations impact a bank's financial health in two primary ways. First, they change the net interest income by altering the spread between earnings on assets and costs of liabilities. Second, they change the market value of assets, liabilities, and off-balance-sheet instruments. The market value is inherently dependent on the present value of future cash flows and discount rates.

45. (B) Risk measurement and monitoring functions should be sufficiently independent from position-taking functions.

To prevent conflicts of interest and ensure objective risk assessment, banks must separate risk management from profit-seeking activities. The units responsible for measuring, monitoring, and controlling interest rate risk should operate independently from the departments that take market positions. This independence ensures that risk limits are strictly enforced and that senior management receives unbiased reports on the bank's actual exposures.

46. (C) Rising interest rates increase the discount rate on future cash flows, thereby decreasing the market value of the asset or liability.

Market value is determined by discounting expected future cash flows. When interest rates rise, the discount rate used in this calculation also increases. As the denominator in the present value formula grows, the resulting market value of the financial asset or liability decreases. Conversely, falling interest rates lead to lower discount rates and an increase in the market value of instruments.

47. (A) I only

Banks must estimate the behavioral patterns of non-maturity deposits, such as savings accounts, to assign them to appropriate time buckets in the ALM system. This is necessary because these deposits lack fixed maturities. If a bank cannot reliably estimate these patterns, it must follow specific regulatory guidelines for bucket placement rather than being automatically required to use internal simulation models.

48. (D) The bank will incur a net loss of 1% (Rs. 1 crore) in the second year.

Initially, the bank earns a 1% spread (10% asset yield minus 9% liability cost). In the second year, the fixed-rate asset still yields 10%, but the liability reprices at 11%. This creates a negative spread of 1% (10% minus 11%). On a principal of Rs. 100 crore, this results in a financial loss of Rs. 1 crore for that year.

49. (B) Exclusively flat-rate statutory adjustments dictated by local municipal authorities.

Enhanced IRRBB guidelines require banks to use multiple scenarios for risk measurement. These include six prescribed interest rate shock scenarios and internally selected shocks based on the bank's ICAAP policy. Additionally, banks must evaluate historical and hypothetical stress scenarios. Relying exclusively on flat-rate adjustments dictated by local municipal authorities is not a recognized or appropriate method for measuring complex banking risks.

50. (C) The bank is asset sensitive, and a rise in market interest rates will produce a larger Net Interest Income.

Alpha Bank is asset sensitive because its loan reprices monthly, while its funding deposit only reprices every 91 days. This means that if market interest rates increase, the bank will benefit from higher income on the loan for most of the period before the cost of the deposit potentially rises. Consequently, rising rates lead to an improved net interest income.

51. (A) Banks would continue to follow existing guidelines applicable to the balance sheet.

Following the finalization of the BCBS standards on Interest Rate Risk in the Banking Book in April 2016, a transition period was established. During this time, before full implementation of the new standards, banks were required to continue following the existing regulatory guidelines applicable to their balance sheets. This ensured continuous risk monitoring while institutions prepared for the more rigorous requirements.

52. (A) I, II, and III only

In this scenario, the bank has a negative gap, and rates are falling. Traditional gap analysis incorrectly predicts an NII improvement. However, because asset rates are falling more than

70. (A) I and II only

Modified duration measures the sensitivity of a position's economic value to small interest rate changes. Generally, instruments with longer maturities or repricing dates have higher durations. This means their values fluctuate more significantly when rates shift. However, instruments with smaller intermediate payments, like low-coupon bonds, actually have higher durations because a larger portion of their total cash flow occurs at maturity.

71. (B) II, I, IV, III

The calculation of the Modified Duration Gap begins with identifying key variables like principal, maturity, and coupon rates. Next, bucket-wise cash flows are generated for each category. Then, a yield curve is established based on current market conditions to determine appropriate yields. Finally, the modified duration for each category is calculated using these maturity dates, yields, and coupon rates.

72. (A) It involves detailed assumptions about interest rates, business activity, and customer behaviour.

Dynamic simulation is an advanced approach to measuring interest rate risk that goes beyond static snapshots. It involves creating detailed scenarios that incorporate assumptions about future interest rate paths, expected changes in business volumes, and customer behavioral patterns like prepayments. This method allows banks to project potential future earnings and economic value under a wide range of complex conditions.

73. (A) 0.85

The Modified Duration Gap (DGAP) is determined using the formula: $DGAP = DA - (W \times DL)$. In this case, multiplying the weighted average modified duration of liabilities (1.50) by the weight factor (1.10) results in 1.65. Subtracting this value from the weighted average modified duration of assets (2.50) yields a final Modified Duration Gap of 0.85 for the bank.

74. (B) I and III only

Behavioral maturities often differ from contractual terms. For example, mortgage borrowers may prepay loans when interest rates decline to refinance at lower costs. Similarly, depositors can

often withdraw non-maturity deposits at any time without penalty. Understanding these patterns is crucial for risk management, as actual cash flows are influenced by customer responses to market changes rather than just legal dates.

75. (A) Rs. 80.00 crore

To find the bucketing amount for the option, the notional value is multiplied by its delta. The notional value is USD 20 million times the strike price of Rs. 80, equaling Rs. 160 crore. Applying the delta of 0.50 to this total results in an outflow of Rs. 80 crore to be recorded in the relevant maturity bucket for risk reporting.

76. (C) It effectively captures interest rate risk arising from changes in the relationship among interest rates.

The standard duration approach has several limitations. It primarily focuses on repricing risk and uses average durations for time bands, which can mask the specific sensitivity of individual positions. Crucially, it does not effectively capture yield curve risk or basis risk, which arise from non-parallel shifts or changes in the relationship between different interest rates across various instruments and maturities.

77. (B) Increase fixed rate lending — Reduces Liability Sensitivity

Increasing fixed-rate lending extends the time until assets are repriced, which actually increases the bank's liability sensitivity rather than reducing it. To reduce liability sensitivity, a bank should focus on actions that either increase the speed of asset repricing, such as floating-rate lending, or delay the repricing of liabilities, such as attracting more long-term fixed-rate deposits.

78. (A) P-3, Q-1, R-2, S-4

Banks use various tools to manage interest rate risk. Swaps and futures create synthetic positions to hedge exposures. Shortening investment maturities reduces asset sensitivity, while extending them reduces liability sensitivity. Finally, establishing gap tolerance limits is a critical risk management practice designed to minimize the adverse impact on net interest income that arises from the unavoidable timing mismatches in banking operations.

weightage of NPAs is lower to provide capital relief to banks.

III. NPAs have a two-fold effect: reduction in income and a need for additional capital.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only
- (D) I, II, and III

May/June 2009

48. On what date was the National Bank for Financing Infrastructure and Development (NaBFID) Act, 2021 enforced?

- (A) 25th October, 2011
- (B) 28 March, 2021
- (C) 1st April, 2022
- (D) 19 April, 2021

Oct/Nov 2025

49. Consider the following statements:

- I. Treasury income is derived from trading in securities, foreign exchange, equities, and bullion.
- II. Banks undertake this largely speculative activity without any internal controls to maximise returns.
- III. Risk management measures include caps on open positions and mark-to-market valuations.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2024

50. Why is a bank's role as a trustee for depositors potentially at variance with its commercial objectives?

- (A) The trustee role strictly prohibits the bank from accepting term deposits, limiting its commercial expansion.
- (B) The trustee role mandates all funds be placed in corporate debt, ignoring government securities entirely.
- (C) The trustee role protects depositors, while the commercial role seeks owner profit.
- (D) The trustee role requires eliminating all fee-based activities to focus solely on interest income streams.

Oct/Nov 2006

51. Consider the following statements:

- I. In the Indian Banking Industry, there has been a transition away from regulated interest rates and directed investment.
- II. Foreign banks have been completely restricted from expansion over the last few decades.
- III. Profitability has now become one of the most important parameters in the banks' functioning.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

May/June 2012

52. Why is the risk-adjusted return on capital (RAROC) methodology crucial for a financial institution with multiple business streams?

- (A) It guarantees that total profits will always exceed total losses across all diversified banking portfolios.
- (B) It replaces the need for maintaining specific reserves and provisions by automating loss mitigation.
- (C) It solely restricts the maximum potential loss to a certain percentage of past income or asset values.
- (D) It evaluates all business streams equally by matching revenues, costs, and risks.

Oct/Nov 2016

53. Consider the following statements regarding Capital Allocation under RAROC:

- I. Expected losses are covered by specific reserves and provisions.
- II. Unexpected losses are determined on the principles of confidence levels, time horizon, diversification, and correlation.
- III. Risk is measured in terms of the invariable nature of income over time.
- IV. The risky position must carry an expected rate of return on allocated capital to compensate for incremental risk.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, II, and IV only
- (C) II, III, and IV only
- (D) I, III, and IV only

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CHAPTER 31

RAROC and Profit Planning

Oct/Nov 2024

1. Consider the following statements regarding bank profitability and risk management:
 - I. Profitability for banks depends strictly on three factors.
 - II. Basel committee norms have brought standardisation in norms for capital adequacy.
 - III. Banks must keep the trade-off between capital requirement and profitability.
 - IV. Banks must optimise the allocation of funds amongst securities, credit portfolios, and forex/bullion positions.
 - V. Risk management processes have attained a key position in the banking arena.
 Which of the above statement(s) is/are correct?
 - (A) I, II, III, and IV only
 - (B) II, III, IV, and V only
 - (C) I, III, IV, and V only
 - (D) I, II, IV, and V only

May/June 2012

2. Which of the following pairs regarding the six variables of profitability is incorrectly matched with its required optimization strategy?
 - (A) Trading income - Maximisation
 - (B) Staff expenses - Minimisation
 - (C) Fee-based income - Minimisation
 - (D) Interest expenses - Minimisation

Oct/Nov 2016

3. In the context of economic capital, what does "expected loss" represent?
 - (A) A measure of the reserves necessary to guard against future losses
 - (B) A definitive loss charged directly to the profit and loss account as inevitable
 - (C) The maximum potential loss restricted to a percentage of current income
 - (D) An unpredictable value change due to interest rate fluctuations

May/June 2005

4. Consider the following statements and select the correct option:

- I. Under the Earnings at Risk (EaR) framework, a bank can restrict the maximum potential loss to a certain percentage of past/current income or market value.
- II. The EaR approach determines current earnings implications by moving exclusively from the volatility of value through capital allocation.
 - (A) Only Statement I is correct.
 - (B) Only Statement II is correct.
 - (C) Both Statement I and Statement II are correct.
 - (D) Neither Statement I nor Statement II is correct.

Oct/Nov 2011

5. How does Economic Value Added (EVA) measure residual economic profit?
 - (A) By adding total profits to the required return on capital
 - (B) By dividing the total profit by the risk capital
 - (C) By subtracting expected losses from the risk-weighted assets
 - (D) By adjusting profits for the cost of economic capital

May/June 2023

6. Which prominent British bank collapsed in the 1990s due to speculative trading of Nikkei Futures on the Tokyo Exchange?
 - (A) Bankers Trust
 - (B) Barings Bank
 - (C) State Bank of India
 - (D) Global Financial Bank

Oct/Nov 2006

7. Consider the following statements and select the correct option:
 - I. The Indian banking industry currently includes Payment Banks, which are classified as Differentiated Banks.
 - II. The Reserve Bank of India is now less concerned about prudential norms and disclosure requirements than it was before

the 1991 deregulation.

- (A) Only Statement I is correct.
- (B) Only Statement II is correct.
- (C) Both Statement I and Statement II are correct.
- (D) Neither Statement I nor Statement II is correct.

May/June 2015

8. Consider the following statements:

- I. Traditional activities like demand drafts and remittances may reduce drastically with technological changes.
- II. New services like internet banking and depository services have resulted in higher minimum balance requirements or given a boost to fee income.
- III. Cross-selling of insurance policies and mutual funds exposes banks to zero operational risks due to third-party liability.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) I and III only
- (C) II and III only
- (D) I, II, and III

Oct/Nov 2021

9. Under the Basel-II/III regime, what is the impact of Non-Performing Assets (NPAs) on a bank's risk weightage?

- (A) The risk weightage of such assets is higher
- (B) The risk weightage of such assets is eliminated
- (C) The risk weightage of such assets remains unchanged
- (D) The risk weightage of such assets is lower

May/June 2009

10. Consider the following statements:

- I. Risk Adjusted Return on Capital (RAROC) is designed to allow all business streams of a financial institution to be evaluated on an equal footing.
- II. It measures expected losses using only historical cash flows while ignoring unexpected losses.
- III. Capital is allocated to activities as a function of a risk or volatility measure.

Which of the above statement(s) is/are correct?

- (A) I and II only
- (B) II and III only
- (C) I and III only

- (D) I, II, and III

Oct/Nov 2014

11. Why do banks need to have a proper blending of investment in government securities and credit portfolios?

- (A) To maximise profits by balancing yields and capital for a specific risk appetite.
- (B) To completely eliminate the need for regulatory capital requirements through aggressive asset reallocation.
- (C) To offset the high yields of government securities with the risk-free nature of corporate debt instruments.
- (D) To ensure that all unexpected losses are converted into expected losses through systematic hedging strategies.

May/June 2018

12. Consider the following statements regarding profit planning and asset mix:

- I. Investment in government securities is practically risk-free but yields lower returns compared to deposit rates.
- II. Interest income on highly rated corporate debt is much higher compared to lower-rated corporate debt.
- III. Banks are required to have a proper blending of government securities and credit portfolios.
- IV. Statutory Liquidity Ratio (SLR) mandates a certain percentage of deposits to be kept in government securities.

Which of the above statement(s) is/are correct?

- (A) I, II, and III only
- (B) I, III, and IV only
- (C) II, III, and IV only
- (D) I, II, III, and IV

Oct/Nov 2019

13. How does Earnings at Risk (EaR) analytically differ from RAROC when analysing interest rate risk?

- (A) EaR relies exclusively on capital allocation rather than standard deviation.
- (B) EaR depends less on capital allocation and more on cash flows or variability in earnings.
- (C) EaR captures value changes in assets and liabilities due to changes in market interest rates.
- (D) EaR evaluates the performance of business lines by adjusting profits for the book value

of assets.

May/June 2007

- 14.** Consider the following statements regarding Economic Capital and Risk Capital:
- I. The pricing of products should provide a buffer against unexpected losses.
 - II. The unexpected loss is a measure of the economic capital required to support financial risk.
 - III. RAROC is a part of the family of risk-adjusted performance measures (RAPM).
 - IV. Return on Assets (ROA) adjusts profits for the associated book value of assets.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) I, III, and IV only
 - (C) II, III, and IV only
 - (D) I, II, III, and IV

Oct/Nov 2018

- 15.** Which of the following accurately describes the treatment of expected and unexpected losses in the RAROC framework?
- (A) Expected losses require capital allocation, while unexpected losses are ignored during auditing.
 - (B) Both expected and unexpected losses are exclusively covered by specific reserves and provisions.
 - (C) Unexpected losses are charged directly to the profit and loss account as inevitable financial losses.
 - (D) Reserves cover expected losses, while capital covers unexpected losses.

May/June 2021

- 16.** Consider the following statements regarding NaBFID:
- I. It was set up as a Development Financial Institution (DFI).
 - II. It received the assent of the President on 28 March, 2021.
 - III. It accepts deposits from the general public.
 - IV. It sources funds from multi-lateral institutions and is often supported by government guarantees.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) II, III, and IV only
 - (C) I, II, and IV only
 - (D) I, III, and IV only

Oct/Nov 2010

- 17.** Which of the following correctly describes a funding characteristic of Development Financial Institutions (DFIs) like NaBFID?
- (A) They accept savings and current deposits directly from individual retail and commercial depositors.
 - (B) They source funds from the market, government, and multi-lateral institutions.
 - (C) They rely entirely on short-term term deposits from retail customers across various demographics.
 - (D) They operate without any financial support provided through sovereign or government guarantees.

May/June 2019

- 18.** Consider the following statements regarding Risk Aggregation approaches:
- I. The Basel Committee considers capital adequacy in relation to economic risk unnecessary for long-term soundness.
 - II. RAROC uses VaR or worst-case type analytical models to determine expected and unexpected losses.
 - III. EaR analyzes interest rate risk by relying heavily on capital allocation rather than cash flows.
 - IV. Extreme outcomes in EaR can be estimated using Standard Deviation $1/2/2.69/3$.
 - V. EaR depends upon a subjectively specified range of risky environments to drive the worst-case scenario.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) II, III, and IV only
 - (C) II, IV, and V only
 - (D) I, III, IV, and V only

Oct/Nov 2025

- 19.** Which of the following statements regarding the impact of NPAs on profitability is incorrect?
- (A) NPAs improve the return on capital by reducing risk-weighted assets.
 - (B) NPAs do not generate income and therefore bring down the overall yield on total advances.
 - (C) NPAs force a bank to maintain higher capital levels under the current Basel-II/III regime.
 - (D) NPAs have a two-fold effect: reduction in income and a need for additional capital

leading to bank collapse.

Oct/Nov 2017

33. Arrange the components of the RAROC Methodology in the logical sequence of their application:

I. Performance Measurement
 II. Risk Management
 III. Capital Allocation
 (A) I, II, III
 (B) III, II, I
 (C) II, III, I
 (D) II, I, III

May/June 2010

34. Apex Bank uses the RAROC methodology where risk capital is computed as a VaR measure at the 99% level using a 2.33 multiplier. Calculate the Risk Capital for Trader B (Bond) who deals in a \$200 million notional amount with 4% annual volatility:
- (A) \$8.00 million
 (B) \$28.00 million
 (C) \$18.64 million
 (D) \$46.60 million

Oct/Nov 2005

35. Match the financial concept (List-I) with its characteristic (List-II):

List I: (Financial Concept)

P. ROA
 Q. RAROC
 R. EaR
 S. EVA

List II: (Characteristic)

1. Focuses on value creation in excess of required return on capital
 2. Adjusts profits for the associated book value of assets but ignores risks
 3. Depends more on cash flows and ignores value changes in assets
 4. Evaluates business streams on equal footing by measuring expected and unexpected losses
- (A) P-2, Q-4, R-3, S-1
 (B) P-1, Q-2, R-4, S-3
 (C) P-3, Q-1, R-2, S-4
 (D) P-4, Q-3, R-1, S-2

May/June 2020

36. Based on the RAPM calculations for the traders at Apex Bank, why is Trader B (Bond) considered

to be performing better than Trader A (FX) despite earning the exact same absolute profit?

- (A) Because Trader B deals in larger notional amounts
 (B) Because Trader B operates in a market with higher volatility
 (C) Because Trader B generates a higher absolute EVA
 (D) Because Trader B's activity requires less risk capital

Oct/Nov 2015

37. Match the specific risk or capital measure (List-I) with its descriptive attribute (List-II):

List I: (Risk or Capital Measure)

P. Expected Loss
 Q. Unexpected Loss
 R. Risk Capital
 S. Aggregate Risk Exposure

List II: (Descriptive Attribute)

1. Requires summation of different types of risks at Head Office level
 2. Measure of reserves necessary to guard against future losses
 3. Buffer representing economic capital to support financial risk
 4. Required to carry an expected rate of return to compensate the bank for incremental risk
- (A) P-3, Q-2, R-1, S-4
 (B) P-1, Q-4, R-2, S-3
 (C) P-2, Q-3, R-4, S-1
 (D) P-4, Q-1, R-3, S-2

May/June 2025

38. What is a primary limitation of the Earnings at Risk (EaR) framework advocated by the second group at Meridian Bank?

- (A) It requires an excessive allocation of economic capital for all expected financial losses.
 (B) It relies entirely on regulatory minimum capital requirements rather than internal data.
 (C) It ignores value changes in assets and liabilities from interest rate shifts.
 (D) It evaluates performance solely by adjusting profits for the book value of shareholder equity.

Reason (R): EaR goes directly to current earnings implications from a risky position rather than moving from volatility of value through capital.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2023

27. What is the central objective of establishing Risk Adjusted Return on Capital (RAROC) measures?
- (A) To establish benchmarks to evaluate the economic return of business activities.
 - (B) To accurately predict the exact amount of expected losses for the next decade of operation.
 - (C) To determine the fixed interest rate for long-term deposits across all retail branches.
 - (D) To ensure that Return on Assets (ROA) precisely matches Return on Equity (ROE) over time.

May/June 2016

28. A bank evaluates a portfolio allocating Rs. 300 to Govt. Securities (Yield 6%, Risk Weight 0%), Rs. 300 to AAA rated customers (Yield 8%, Risk Weight 20%), and Rs. 400 to AA rated customers (Yield 10%, Risk Weight 50%). What is the total Capital Required assuming a regulatory requirement of 11.50%?
- (A) Rs. 13.80
 - (B) Rs. 20.80
 - (C) Rs. 29.90
 - (D) Rs. 41.40

Oct/Nov 2009

29. What is the primary reason banks must ensure wasteful expenditures are avoided and optimal deals are achieved in their operating costs?
- (A) To entirely eliminate the need for regulatory capital through extreme operational efficiency.
 - (B) To rationalise expenditure and reduce the percentage of staff costs to income.
 - (C) To fund the speculative trading activities in foreign exchange and international commodities.

- (D) To offset the fixed interest paid on current deposits which are traditionally interest-free.

May/June 2024

30. GlobalTrust Bank has recently expanded its treasury operations, engaging heavily in trading foreign exchange and derivatives. In the last financial quarter, this division reported unprecedented large incomes. To prevent a scenario similar to the historical collapse of Barings Bank, which of the following measures MUST GlobalTrust Bank ensure are actively in place?
- (A) Increasing reliance solely on traditional fee-based safe custody and advisory services.
 - (B) Converting all retail term deposits to current deposits immediately to manage liquidity.
 - (C) Internal controls, caps on open positions, and mark to market valuations.
 - (D) Completely ceasing all treasury income activities to focus on retail banking exclusively.

Oct/Nov 2007

31. What fundamental shift was initiated in the Indian banking industry starting with the Narasimham committee report of 1991?
- (A) The immediate mandatory merger of all Old Generation Private Sector Banks into public sector units.
 - (B) The strict enforcement of fixed minimum returns for all public sector bank equity holders annually.
 - (C) The complete prohibition of all foreign banks from operating within the sovereign borders of India.
 - (D) A process of deregulation phasing out regulated interest rates and directed credit.

May/June 2006

32. If GlobalTrust Bank experiences large amounts of losses from these derivatives but is NOT adequately capitalised, what is the most likely outcome?
- (A) It will seamlessly transition to a Development Financial Institution model under RBI.
 - (B) The losses will be offset automatically by high statutory liquidity ratios in place.
 - (C) Expected losses will be entirely absorbed by its existing savings deposits balances.
 - (D) It can cause serious problems, potentially

- 79.** (D) The bank faces reinvestment risk because it can only reinvest the coupons at lower yields. The bank has a liability (zero-coupon deposit) that requires no payments until maturity. However, its asset (coupon bond) generates annual cash flows. If interest rates fall, the bank will be forced to reinvest those annual coupon payments at the lower prevailing market rates (10%) instead of the initial 12%. This mismatch leads to reinvestment risk, potentially reducing the total final return.
- 80.** (D) Outsourcing the risk identification to third-party firms. Effective internal controls for interest rate risk require a strong internal culture, clear policies, and regular reviews of compliance. While banks may use third-party tools or consultants, they cannot outsource the fundamental responsibility of risk identification and management. The institution must maintain internal expertise and systems to ensure that its specific risk profile is continuously monitored and controlled by management.

Oct/Nov 2013

39. Which of the following pairs of income source and its corresponding activity is correctly matched?
- (A) Treasury income - Safekeeping and safe custody of guarantees
 - (B) Interest income - Investments in government securities and bonds
 - (C) Fee-based income - Trading in foreign exchange and equities
 - (D) Operating income - Infusion of capital based on value at risk

May/June 2017

40. Omni Bank evaluates a new corporate loan product. Over a particular period, the product generates profits of Rs. 50 million. The bank determines that the economic capital allocated to support this product is Rs. 300 million, and the discount rate (cost of economic capital, k) is 10%. What is the Economic Value Added (EVA) for this product?
- (A) Rs. 20 million
 - (B) Rs. 30 million
 - (C) Rs. 47 million
 - (D) Rs. 80 million

Oct/Nov 2022

41. Which of the following pairs of expenditure categories and their components is incorrectly matched?
- (A) Interest expenses - Legal and travelling expenses
 - (B) Operating costs - Depreciation and utilities
 - (C) Interest expenses - Cost of savings and term deposits
 - (D) Operating costs - Postal and telecommunication charges

May/June 2014

42. Profit planning in a bank essentially involves which of the following?
- (A) Liquidation of non-performing assets
 - (B) Balance sheet management
 - (C) Elimination of all operational risks
 - (D) Strict adherence to retail banking limits

Oct/Nov 2010

43. Consider the following statements and select the correct option:
- I. Banks are commercial organisations expected to provide good returns on equity.
 - II. As trustees for depositors, a bank's role to

protect funds is always in perfect harmony with maximising profits for owners.

- (A) Only Statement I is correct.
- (B) Only Statement II is correct.
- (C) Both Statement I and Statement II are correct.
- (D) Neither Statement I nor Statement II is correct.

May/June 2005

44. How is the "unexpected loss" defined in relation to a bank's financial risk?
- (A) An indicator reflecting the absolute inferiority of the bank's entire credit portfolio.
 - (B) A static value derived solely from historical operating expenses and overhead costs.
 - (C) A measure of economic capital supporting financial risk.
 - (D) An accounting standard used to dictate minimum reserve requirements for liquidity.

Oct/Nov 2021

45. Consider the following statements and select the correct option:
- I. Return on Assets (ROA) and Return on Equity (ROE) are satisfactory measures for evaluating the performance of business lines because they account for risks.
 - II. Economic Value Added (EVA) measures the residual economic profit by adjusting profits for the cost of economic capital.
- (A) Only Statement I is correct.
 - (B) Only Statement II is correct.
 - (C) Both Statement I and Statement II are correct.
 - (D) Neither Statement I nor Statement II is correct.

May/June 2018

46. On which date were savings deposits interest rates deregulated in India?
- (A) 19 April, 2021
 - (B) 28 March, 2021
 - (C) 25th October, 2011
 - (D) 1st April, 2000

Oct/Nov 2014

47. Consider the following statements:
- I. NPAs do not generate income and thereby bring down the yield on advances.
 - II. Under the Basel-II/III regime, the risk

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reserves.

May/June 2008

20. Consider the following statements regarding banking developments in India:

- I. The Indian banking scenario has seen a total change since the Narasimham committee report of 1991.
- II. Regulated interest rates and directed investment are currently the primary drivers of Indian banking.
- III. Bharatiya Mahila Bank has merged with State Bank of India.
- IV. Banks have realised that capital is a must to take up risk.
- V. Small Finance Banks are excluded from the definition of the Banking Industry in India.

Which of the above statement(s) is/are correct?

- (A) I, II, and V only
- (B) I, III, and IV only
- (C) II, IV, and V only
- (D) I, III, IV, and V only

Oct/Nov 2012

21. Which of the following statements about Earnings at Risk (EaR) is incorrect?

- (A) It is employed to analyse interest rate risk.
- (B) Extreme outcomes can be estimated from the tail of the distribution.
- (C) It depends upon a subjectively specified range of risky environments to drive the worst-case scenario.
- (D) It captures the value changes in assets and liabilities due to changes in market interest rates.

May/June 2013

22. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below.

Assertion (A): Banks are required to have a proper blending of investment in government securities and credit portfolios.

Reason (R): Government securities provide much higher yields than lower-rated corporate debt, thus maximizing profits without any risk.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation

of Assertion (A).

- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2008

23. The RAROC approach determines capital allocation for unexpected losses based on the principles of all of the following, EXCEPT:

- (A) Confidence levels
- (B) Subjective cash flow specification
- (C) Time horizon
- (D) Diversification and correlation

May/June 2011

24. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below.

Assertion (A): Banks make concerted efforts to focus on deposit mobilization under the CASA (Current and Savings Account) head.

Reason (R): Current deposits are interest-free and savings deposits have low interest rates, thereby helping banks lower their overall interest costs.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

Oct/Nov 2020

25. Profitability of a bank is a function of six variables. All of the following are among these variables, EXCEPT:

- (A) Statutory Liquidity Ratio
- (B) Fee-based income
- (C) Staff expenses
- (D) Trading income

May/June 2022

26. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below.

Assertion (A): In the Earnings at Risk (EaR) approach, the framework completely accounts for the value changes in assets and liabilities due to changes in market interest rates.

May/June 2011

54. Which of the following is a correct statement regarding treasury income in banks?
- (A) It is primarily derived from safe custody, guarantees, and the issuance of letters of credit.
 - (B) It is a risk-free activity that does not require internal controls or oversight mechanisms.
 - (C) A speculative activity requiring risk measures like caps on open positions.
 - (D) It is an activity entirely prohibited for banks in India under current regulatory statutes.

Oct/Nov 2018

55. Consider the following statements regarding Bank Expenditure:
- I. Interest expenses on Savings Deposits are paid on a daily product basis.
 - II. Current Deposits are interest-free.
 - III. Interest rates of term deposits are largely decided by market forces.
 - IV. Staff costs cannot be linked to productivity under any circumstances.
- Which of the above statement(s) is/are correct?
- (A) I, II, and III only
 - (B) II, III, and IV only
 - (C) I, III, and IV only
 - (D) I, II, and IV only

May/June 2015

56. Which of the following statements about the Indian banking industry deregulation is correct?
- (A) Deregulation has successfully brought regulated interest rates to an end.
 - (B) Directed investment and regulated interest rates are the current fundamental pillars of Indian banking.
 - (C) The Reserve Bank of India is no longer concerned about prudential norms and disclosure requirements.
 - (D) Foreign banks have been strictly denied clearances for expansion in recent decades by regulators.

Oct/Nov 2011

57. Consider the following statements regarding the variables of profitability:
- I. Interest income is derived solely from lending and excludes investments in securities.
 - II. Fee-based income is being boosted by depository services and internet banking.

- III. Trading activities may result in large amounts of losses if a bank is not adequately capitalised.
- IV. Staff expenses are a component of operating costs.
- V. Profitability requires the maximisation of interest expenses and minimisation of trading income.

Which of the above statement(s) is/are correct?

- (B) II, III, and IV only
- (A) I, II, and V only
- (C) III, IV, and V only
- (D) I, III, IV, and V only

May/June 2023

58. Which of the following statements regarding the factors of bank expenditure is incorrect?
- (A) Operating costs consist of staff costs and other costs like depreciation, rent, and office utilities.
 - (B) Interest expenses on term deposits are fixed by the RBI and not market-influenced.
 - (C) Banks try to improve productivity by linking staff costs to productivity via incentive-based packages.
 - (D) Every effort is made to maintain and reduce the percentage of staff costs relative to the income level.

Oct/Nov 2019

59. Consider the following statements regarding the comparison between a Foreign Exchange (FX) trader and a Bond trader:
- I. Both traders returned a profit of \$10 million over the last year.
 - II. The Bond trader dealt in smaller notional amounts than the FX trader.
 - III. The FX trader operated in a market with higher volatility (12%) compared to the Bond trader (4%).
 - IV. The risk capital was computed as a VAR measure at the 99% level over a year.
 - V. The FX trader actually performed better than the Bond trader when evaluating Risk Adjusted Performance (RAPM).

Which of the above statement(s) is/are correct?

- (A) I, II, and V only
- (B) II, III, and V only
- (C) I, III, and IV only
- (D) I, II, III, and IV only

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and liabilities; it focuses on current earnings implications. The reason is true because EaR evaluates the impact of risky positions directly on earnings rather than using the capital allocation method derived from value volatility. Thus, EaR provides a different analytical perspective than value-based risk measures.

27. (A) To establish benchmarks to evaluate the economic return of business activities

The primary goal of RAROC is to provide a consistent framework for measuring the performance of different business lines on a risk-adjusted basis. By considering both expected and unexpected losses, it allows banks to set benchmarks and determine if specific activities are generating sufficient returns relative to the risk capital they consume. This facilitates better strategic decision-making and efficient capital allocation.

28. (C) Rs. 29.90

To find the capital required, first calculate risk-weighted assets: Govt. Securities ($300 \times 0\% = 0$), AAA customers ($300 \times 20\% = 60$), and AA customers ($400 \times 50\% = 200$). The total RWA is 260. Applying the 11.50% regulatory requirement to 260 results in 29.90. This calculation demonstrates how different asset classes contribute to the total capital a bank must maintain to support its credit risk.

29. (B) To rationalise expenditure and reduce the percentage of staff costs to income

Banks focus on operational efficiency and cost management to improve their bottom line. Since staff costs and overheads represent significant portions of operating expenses, reducing wasteful spending and optimizing deals helps lower the cost-to-income ratio. This rationalization of expenditure is essential for maintaining competitiveness and ensuring that a larger portion of revenue translates into net profit for the banking institution.

30. (C) I and III only

To manage the risks associated with speculative treasury and derivative trading, banks must implement robust internal controls. This includes setting strict limits on open positions to prevent excessive exposure and using mark-to-market valuations to reflect current market prices. These

measures are essential to identify potential losses early and prevent the kind of catastrophic failure seen in historical cases like the Barings Bank collapse.

31. (D) A process of deregulation phasing out regulated interest rates and directed credit

The 1991 Narasimham Committee report marked a turning point for Indian banking by initiating deep structural reforms. This shift focused on moving away from a highly controlled environment characterized by regulated interest rates and mandatory lending quotas. Instead, the industry transitioned toward deregulation, market-driven interest rates, and enhanced prudential norms, which forced banks to become more competitive, efficient, and focused on risk management.

32. (D) It can cause serious problems, potentially leading to bank collapse

When a bank engages in high-risk activities like derivative trading without sufficient capital to absorb potential losses, it faces severe liquidity and solvency risks. If these losses exceed the bank's available capital and reserves, it can lead to a loss of depositor confidence and a systemic crisis. Historically, such situations have resulted in the total collapse of major financial institutions due to inadequate capital.

33. (C) II, III, I

The logical sequence of the RAROC methodology begins with risk management, which involves choosing confidence levels and measuring portfolio volatility. Once risks are quantified, the next step is capital allocation, where economic capital is assigned based on those risk measures. Finally, performance measurement occurs by adjusting the earned profits against the allocated risk capital to determine the true risk-adjusted return of the activity.

34. (C) \$18.64 million

Risk capital is calculated by multiplying the notional amount by the annual volatility and the chosen multiplier. For the bond trader, this involves multiplying the \$200 million notional amount by 4% volatility and the 2.33 multiplier. The resulting calculation ($\$200\text{m} \times 0.04 \times 2.33$) equals \$18.64 million. This figure represents the

Oct/Nov 2024

67. A bank has Rs. 1,000 to invest. It evaluates a portfolio allocating Rs. 300 to Govt. Securities (Yield 6%, Risk Weight 0%), Rs. 300 to AAA rated customers (Yield 8%, Risk Weight 20%), and Rs. 400 to AA rated customers (Yield 10%, Risk Weight 50%). What is the total amount of Risk Weighted Assets generated by this specific portfolio mix?
- (A) Rs. 260
(B) Rs. 120
(C) Rs. 360
(D) Rs. 1000

May/June 2025

68. How do banks primarily attempt to lower interest costs related to deposits?
- (A) By completely ceasing the acceptance of all term deposits from retail customers.
(B) By mandating that all corporate clients maintain zero-balance current accounts.
(C) By linking term deposit rates inversely to the Statutory Liquidity Ratio (SLR).
(D) By focusing on deposit mobilization under the CASA head.

Oct/Nov 2015

69. If the bank shifted from Scenario III (lending to AAA and AA customers) to a mix that increases lending to A-rated customers (12% yield and 100% risk weight), what fundamental trade-off is the bank executing?
- (A) Decreasing both total yield and risk weighted assets simultaneously through safe lending.
(B) Increasing risk weighted assets primarily to lower the total capital requirement of banks.
(C) Eliminating operational risk while maintaining a constant capital adequacy ratio globally.
(D) Accepting more risk and higher capital requirements to achieve an improved asset yield.

May/June 2022

70. In the Earnings at Risk (EaR) framework, how is the extreme outcome usually estimated?
- (A) From the sum total of all interest expenses incurred over a rolling five-year fiscal period.
(B) By calculating the exact correlation between operating costs and net fee-based bank income.

- (C) From the distribution tail using worst-case scenarios or standard deviations.
(D) By relying exclusively on the statutory liquidity ratio prescribed by the central bank authority.

Oct/Nov 2022

71. The treasury activity at GlobalTrust Bank involving heavy engagement in speculative trading of foreign exchange and derivatives is classified as what type of activity?
- (A) A purely fee-based intermediary activity
(B) A speculative activity
(C) A traditional non-fund based activity
(D) A fully risk-free government securities trading activity

May/June 2017

72. Arrange the following developments in the Indian banking sector in chronological order:
- I. Establishment of NaBFID as a DFI
II. Narasimham committee report
III. Deregulation of savings deposits interest rates
- (A) I, II, III
(B) II, III, I
(C) III, II, I
(D) II, I, III

Oct/Nov 2023

73. Apex Bank uses the RAROC methodology to evaluate two traders. Trader A (FX) returns a profit of \$10 million, with a notional amount of \$100 million and 12% volatility. Risk capital is computed as a VaR measure at the 99% level over a year using a 2.33 multiplier. What is the precise Risk Capital (RC) calculated for Trader A (FX) (prior to rounding)?
- (A) \$27.96 million
(B) \$12.00 million
(C) \$18.64 million
(D) \$32.40 million

May/June 2014

74. Match the investment scenario (List-I) with its corresponding yield and risk weight (List-II):
- List I: (Investment Scenario)
P. Investment in Govt. Securities
Q. Lending to AAA rated customers
R. Lending to AA rated customers
S. Lending to A rated customers
- List II: (Yield and Risk Weight)

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May/June 2019

60. Which of the following statements regarding ROA and ROE is incorrect?
- (A) Performance was measured in the past by traditional yardsticks such as return on total bank assets.
 - (B) Return on equity (ROE) adjusts profits for the associated book value of equity held by shareholders.
 - (C) ROA and ROE are satisfactory measures for business lines because they account for risks.
 - (D) ROA adjusts profits for the associated book value of assets held within the bank's balance sheet.

Oct/Nov 2020

61. Consider the following statements regarding bank profitability and risk management:
- I. Profitability for banks depends strictly on three factors.
 - II. Basel committee norms have brought standardisation in norms for capital adequacy.
 - III. Banks must keep the trade-off between capital requirement and profitability.
 - IV. Banks must optimise the allocation of funds amongst securities, credit portfolios, and forex/bullion positions.
 - V. Risk management processes have attained a key position in the banking arena.
- Which of the above statement(s) is/are correct?
- (A) I, II, III, and IV only
 - (B) II, III, IV, and V only
 - (C) I, III, IV, and V only
 - (D) I, II, IV, and V only

May/June 2016

62. All of the following are components of a bank's operating costs, EXCEPT:
- (A) Telecommunication charges
 - (B) Depreciation
 - (C) Interest paid on Savings Deposits
 - (D) Legal expenses

Oct/Nov 2007

63. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below.
- Assertion (A): The return on capital or profitability of a bank deteriorates when Non-

Performing Assets (NPAs) increase.

Reason (R): NPAs do not generate income and concurrently require the bank to maintain higher capital due to their higher risk weightage under the Basel-II/III regime.

- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
- (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (C) Assertion (A) is true, but Reason (R) is false.
- (D) Assertion (A) is false, but Reason (R) is true.

May/June 2021

64. The banking industry in India consists of all of the following types of banks, EXCEPT:
- (A) Regional Rural Banks
 - (B) Old Generation Private Sector Banks
 - (C) Small Finance Banks
 - (D) Global Sovereign Wealth Banks

Oct/Nov 2013

65. The following question consists of two statements, one labelled as Assertion (A) and the other as Reason (R). Select the correct answer using the codes given below.
- Assertion (A): Return on Assets (ROA) and Return on Equity (ROE) are not satisfactory measures for evaluating the true performance of business lines.
- Reason (R): ROA and ROE ignore the risks associated with the business activities while adjusting profits for the book value of assets or equity.
- (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A).
 - (B) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
 - (C) Assertion (A) is true, but Reason (R) is false.
 - (D) Assertion (A) is false, but Reason (R) is true.

May/June 2007

66. Risk capital should account for all of the following, EXCEPT:
- (A) Credit risk
 - (B) Operational risk
 - (C) Shareholder value analysis
 - (D) Any interaction between risk factors

ANSWERS

1. (B) II, III, IV, and V only
Profitability and risk management in banking involve multiple complex factors beyond just three. Standardisation in capital adequacy was achieved through Basel committee norms. Effective banking operations require maintaining a balance between capital requirements and profitability. Optimising fund allocation across various assets like securities and credit portfolios is essential for risk management and financial stability within the modern banking landscape.
2. (C) Fee-based income - Minimisation
Fee-based income is a crucial revenue stream for banks, derived from services like guarantees and internet banking. Unlike expenses, which should be minimised to increase efficiency, fee-based income should be maximised to enhance overall profitability. Minimising this income would negatively impact the financial health and growth of the institution, contradicting standard banking objectives for revenue generation and business expansion.
3. (A) A measure of the reserves necessary to guard against future losses
Expected loss in the context of economic capital represents the anticipated average loss a bank expects to incur from its credit or market activities over a specific period. It serves as a basis for determining the necessary reserves and provisions to protect the institution's financial stability. These losses are generally seen as a normal and predictable cost of doing business.
4. (A) Only Statement I is correct.
The Earnings at Risk framework allows banks to quantify potential income fluctuations by setting limits on losses as a percentage of current earnings. Statement II is incorrect because this approach focuses on the direct impact of risky positions on current earnings rather than moving through capital allocation based on value volatility. It provides a shorter-term perspective on managing interest rate risk.
5. (D) By adjusting profits for the cost of economic capital
Economic Value Added serves as a performance metric that calculates the residual wealth created by a business after accounting for the cost of capital. It determines if the returns generated exceed the required return on the economic capital employed. By subtracting the capital charge from the net profit, it provides a clear picture of true value creation for the bank's shareholders.
6. (B) Barings Bank
Barings Bank, a historic British merchant institution, collapsed in 1995 following massive losses from unauthorised speculative trading. A single trader engaged in high-risk activities involving Nikkei 225 futures on the Singapore and Tokyo exchanges. This failure highlighted the critical importance of internal controls, risk management systems, and oversight in preventing catastrophic financial losses within the global banking industry today.
7. (A) Only Statement I is correct.
Payment Banks are a category of differentiated banks in the Indian financial system designed to further financial inclusion. Statement II is false because the Reserve Bank of India has actually increased its focus on prudential norms and transparency following the 1991 reforms. Modern regulation emphasises stringent disclosure requirements to ensure the safety and stability of the entire Indian banking sector.
8. (A) I and II only
Technological advancements have significantly altered traditional banking activities like remittances while promoting newer services like internet banking that boost fee income. Statement III is incorrect because cross-selling third-party products like insurance still involves operational and reputational risks for banks. While these services diversify income streams, they require careful management to mitigate potential liabilities and ensure compliance with regulatory standards.

1. Yield 8% p.a. & risk weight 20%
2. Yield 12% p.a. & risk weight 100%
3. Yield 6% & risk weight 0%
4. Yield 10% p.a. & risk weight 50%

- (A) P-3, Q-1, R-4, S-2
 (B) P-1, Q-2, R-3, S-4
 (C) P-4, Q-3, R-2, S-1
 (D) P-2, Q-4, R-1, S-3

Oct/Nov 2008

75. Once the risk capital is determined for business activities, how is the Risk-Adjusted Performance (RAPM) measured in the RAROC framework?
- (A) By dividing the profit by the risk capital
 (B) By dividing the risk capital by the profit
 (C) By multiplying the profit by the VAR measure
 (D) By subtracting the expected loss from the profit

May/June 2010

76. Match the profitability variable (List-I) with its correct categorization (List-II):

List I: (Profitability Variable)

- P. Fee-based income
 Q. Staff expenses
 R. Treasury income
 S. Interest expenses

List II: (Categorization)

1. Variable to be minimised (Operating expense)
2. Variable to be maximised (Derived from traditional and new services)
3. Variable to be minimised (Cost of deposits)
4. Variable to be maximised (Derived from trading activities)

- (A) P-1, Q-3, R-2, S-4
 (B) P-2, Q-1, R-4, S-3
 (C) P-3, Q-4, R-1, S-2
 (D) P-4, Q-2, R-3, S-1

Oct/Nov 2009

77. Meridian Bank's Asset Liability Committee is analyzing interest rate risk. One group prefers an analytical framework that focuses heavily on cash flows, limits maximum potential loss to a percentage of current income, and uses historical data to estimate extreme outcomes in earnings without allocating capital directly. Which framework is this group advocating for?
- (A) Economic Value Added (EVA)
 (B) Earnings at Risk (EaR)

- (C) Risk Adjusted Return on Capital (RAROC)
 (D) Return on Assets (ROA)

May/June 2006

78. Match the institutional entity/development (List-I) with its associated detail (List-II):

List I: (Institutional Entity)

- P. Barings Bank
 Q. Bharatiya Mahila Bank
 R. Small Finance Banks
 S. NaBFID

List II: (Associated Detail)

1. Differentiated Banks permitted by RBI
2. Merged with State Bank of India
3. Collapsed due to speculative trading of Nikkei Futures
4. Development Financial Institution supporting long-term infrastructure

- (A) P-1, Q-3, R-4, S-2
 (B) P-2, Q-4, R-1, S-3
 (C) P-3, Q-2, R-1, S-4
 (D) P-4, Q-1, R-2, S-3

Oct/Nov 2012

79. If a bank decides to use the Standard Deviation method to estimate an extreme outcome within the EaR framework, which of the following sets of multipliers could be considered?

- (A) 0.5 / 1.0 / 1.5
 (B) 1 / 2 / 2.69 / 3
 (C) 1.65 / 2.33 / 2.58
 (D) 3 / 4 / 5 / 6

May/June 2020

80. Which of the following pairs regarding RAROC Methodology is correctly matched?

- (A) Risk Management - Choice of a confidence level and horizon for the VAR measure
 (B) Capital Allocation - Measurement of portfolio exposure, volatility and correlations
 (C) Economic Capital - Translation of expected loss into specific reserves
 (D) Performance Measurement - Adjustment of performance for the risk capital

lateral organisations. This approach allows them to finance large-scale infrastructure projects that require significant capital and have much longer gestation periods than typical loans.

18. (C) II, IV, and V only
RAROC employs Value at Risk models to quantify losses, while Earnings at Risk uses statistical distributions or subjective scenarios to estimate potential income fluctuations. Statement I is false because the Basel Committee emphasizes that capital adequacy is vital for soundness. Statement III is incorrect because EaR prioritizes cash flows over capital allocation when evaluating interest rate risks and potential earnings.
19. (A) NPAs improve the return on capital by reducing risk-weighted assets
This statement is incorrect because Non-Performing Assets actually deteriorate the return on capital. They stop generating interest income while requiring higher risk weightings under regulatory frameworks like Basel III. This increase in risk weights necessitates more capital allocation, which, combined with the loss of income, significantly lowers the overall profitability and financial efficiency of the bank's total lending operations.
20. (B) I, III, and IV only
Since 1991, Indian banking has shifted toward deregulation and risk-based capital management. Bharatiya Mahila Bank's merger with the State Bank of India reflects the ongoing consolidation. Statement II is incorrect as regulated rates and directed credit are being phased out. Statement V is incorrect because Small Finance Banks are an integral part of the modern Indian banking industry's landscape.
21. (D) It captures the value changes in assets and liabilities due to changes in market interest rates
This statement is incorrect because capturing value changes in assets and liabilities is a characteristic of Value at Risk or RAROC, not Earnings at Risk. EaR focuses specifically on the volatility of earnings and cash flows resulting from interest rate changes over a defined period. It does not measure the impact on the economic value of the bank's entire balance sheet.
22. (C) Assertion (A) is true, but Reason (R) is false.
Banks must blend government securities and credit portfolios to balance liquidity and returns. However, the reason is false because government securities typically offer lower yields than corporate debt due to their risk-free nature. Profit maximisation involves accepting higher-risk corporate loans alongside safer investments. Therefore, the assertion about blending is correct, but the claim regarding yields and risk-free profit is inaccurate.
23. (B) Subjective cash flow specification
The RAROC framework utilizes rigorous statistical and financial principles to determine capital allocation for unexpected losses. It relies on objective measures like confidence levels, time horizons for loss estimation, and the effects of portfolio diversification and correlation. Unlike Earnings at Risk, which may involve some subjective scenario planning, RAROC focuses on quantifiable risk metrics to ensure adequate capitalisation against potential financial shocks.
24. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A)
Banks actively prioritize Current and Savings Account deposits because they are a cost-effective source of funding. Current accounts generally pay no interest, while savings accounts offer relatively low rates compared to term deposits. By increasing the proportion of CASA funds, banks can significantly reduce their overall interest expenses, thereby improving their net interest margin and enhancing the overall profitability of operations.
25. (A) Statutory Liquidity Ratio
While the Statutory Liquidity Ratio is a regulatory requirement, it is not considered one of the six primary variables that directly determine a bank's profitability. The core variables include interest income, fee-based income, and trading income as revenue sources, alongside interest expenses, staff costs, and other operating expenses as costs. Profitability is managed by optimizing these specific income and expense categories.
26. (D) Assertion (A) is false, but Reason (R) is true.
The assertion is false because Earnings at Risk does not fully account for value changes in assets

9. (A) The risk weightage of such assets is higher
Non-Performing Assets adversely affect a bank's capital adequacy because they carry higher risk weights under Basel II and III frameworks. As asset quality deteriorates, the regulatory capital required to support these assets increases significantly. This mechanism ensures that banks maintain a larger cushion against potential losses from defaults, which simultaneously reduces the funds available for more profitable and efficient lending.
10. (C) I and III only
Risk Adjusted Return on Capital is a framework that allows for the uniform evaluation of diverse business activities by considering their specific risks. It allocates capital based on the volatility or risk of the activity. Statement II is incorrect because RAROC specifically considers both expected and unexpected losses to determine the true risk-adjusted performance and the necessary economic capital levels.
11. (A) To maximise profits by balancing yields and capital for a specific risk appetite
Banks must strategically balance their asset mix between low-risk government securities and higher-yield credit portfolios to optimise profitability. This blending ensures that the institution meets regulatory liquidity requirements while also seeking higher returns from corporate lending. Proper allocation allows the bank to manage its overall risk profile while maintaining sufficient capital to absorb potential losses within its chosen risk appetite.
12. (B) I, III, and IV only
Government securities are generally risk-free but offer lower yields, while statutory liquidity ratios mandate their inclusion in bank portfolios. Statement II is incorrect because lower-rated corporate debt typically offers higher yields to compensate for the increased risk of default compared to highly rated debt. Successful profit planning involves balancing these various assets to meet regulatory standards while achieving sustainable returns.
13. (B) EaR depends less on capital allocation and more on cash flows or variability in earnings
Earnings at Risk focuses on how interest rate fluctuations impact current earnings and cash flows over a short-term horizon. Unlike RAROC, which allocates economic capital based on the volatility of asset values, EaR directly assesses the potential reduction in net interest income. This method is particularly useful for measuring the immediate impact of market changes on a bank's ongoing profitability.
14. (C) II, III, and IV only
Unexpected losses represent the economic capital needed to cover potential risks, while RAROC and Return on Assets serve as key performance metrics. Statement I is incorrect because the pricing of products should primarily provide a buffer against expected losses through provisions. Unexpected losses are instead supported by the bank's capital base to ensure long-term solvency during extreme market events.
15. (D) Reserves cover expected losses, while capital covers unexpected losses
In standard banking risk frameworks, expected losses are anticipated costs of doing business and are handled through specific reserves and provisions. In contrast, unexpected losses represent extreme but plausible events that could threaten solvency. Therefore, banks must maintain a robust capital base to absorb these unexpected shocks, ensuring that the institution remains stable even during severe economic downturns or crises.
16. (C) I, II, and IV only
The National Bank for Financing Infrastructure and Development is a specialised institution focused on long-term infrastructure funding. It received presidential assent in March 2021 and relies on government-backed funding and multi-lateral institutions. Statement III is incorrect because, as a development financial institution, it does not accept deposits from the general public, unlike commercial banks that handle retail and savings accounts.
17. (B) They source funds from the market, government, and multi-lateral institutions
Development Financial Institutions like NaBFID have unique funding structures designed for long-term lending. Instead of relying on retail deposits from the public, they raise capital through the issuance of bonds, government support, and loans from international multi-

amount of economic capital required to support the risks associated with this trading activity.

35. (A) P-2, Q-4, R-3, S-1

ROA measures performance using book value but ignores risk. RAROC evaluates business streams by considering both expected and unexpected losses. Earnings at Risk depends on cash flows and ignores asset value changes. Economic Value Added focuses on generating returns in excess of the required cost of capital. These different metrics provide various perspectives on a bank's financial performance, risk profile, and value creation.

36. (D) Because Trader B's activity requires less risk capital

Although both traders generated the same absolute profit, the bond trader achieved this while taking significantly less risk, as evidenced by the lower annual volatility and resulting lower risk capital. Under risk-adjusted performance measures like RAROC, the trader who uses less capital to produce the same return is considered more efficient and better performing, as they provide a higher return per risk unit.

37. (C) P-2, Q-3, R-4, S-1

Expected loss relates to reserves for anticipated future losses, while unexpected loss represents the economic capital needed for financial risk support. Risk capital requires a return to compensate for incremental risk taken. Aggregate risk exposure involves summing different types of risks at the organizational level. These concepts are foundational to modern bank management, ensuring that institutions are adequately protected against financial uncertainty.

38. (C) It ignores value changes in assets and liabilities from interest rate shifts

A significant limitation of the Earnings at Risk framework is its narrow focus on current earnings and cash flows. By ignoring the impact of interest rate changes on the economic value of a bank's assets and liabilities, it fails to provide a comprehensive view of long-term solvency. This perspective can miss the potential decline in the institution's overall net worth despite stable earnings.

39. (B) Interest income - Investments in government securities and bonds

Interest income for banks is primarily generated from lending activities and investments in interest-bearing instruments like government securities and corporate bonds. Option A is incorrect because treasury income involves active trading, while safe custody relates to fee income. Option C is incorrect because fee income comes from services, not speculative trading. Option D is incorrect because operating income is revenue, not a capital infusion.

40. (A) Rs. 20 million

Economic Value Added is calculated by subtracting the capital charge from the total profit. The capital charge is determined by multiplying the economic capital (Rs. 300 million) by the cost of capital (10%), which equals Rs. 30 million. Subtracting this charge from the Rs. 50 million profit results in an EVA of Rs. 20 million, indicating that the product successfully created residual economic profit.

41. (A) Interest expenses - Legal and travelling expenses

Interest expenses strictly refer to the costs associated with deposits and borrowings, such as interest paid on savings and term deposits. Legal and travelling expenses are instead categorized as operating costs. Operating costs also include items like depreciation, utilities, rent, and communication charges. Therefore, pairing legal and travel expenses with interest expenses is incorrect within standard banking accounting and financial reporting frameworks.

42. (B) Balance sheet management

Profit planning in a bank is a comprehensive process that involves strategic balance sheet management. This includes optimizing the mix of assets and liabilities to maximize income while managing risks and meeting regulatory requirements. By balancing high-yield loans with liquid government securities and managing the cost of deposits, banks aim to achieve sustainable profitability and maintain the financial health of the entire institution.

43. (A) Only Statement I is correct.

Banks are indeed commercial entities that strive to provide competitive returns to their equity

holders. However, Statement II is incorrect because a bank's role as a trustee for depositors—focusing on safety and liquidity—can often conflict with the goal of maximizing profits for owners. High-profit strategies frequently involve taking greater risks, which may not always align with the interests of depositors.

44. (C) A measure of economic capital supporting financial risk

Unexpected loss is a critical concept in risk management, representing potential losses that exceed the average or expected levels. Unlike expected losses, which are covered by provisions, unexpected losses must be supported by the bank's economic capital. This capital serves as a buffer to ensure the bank remains solvent during extreme market fluctuations or severe economic downturns, protecting the interests of depositors.

45. (B) Only Statement II is correct.

Economic Value Added is an effective tool for measuring residual profit after accounting for the cost of capital. Statement I is incorrect because traditional metrics like ROA and ROE, while useful, are not satisfactory for evaluating business lines because they fail to account for the specific risks involved in those activities. Modern banking performance management prefers risk-adjusted measures for accuracy.

46. (C) 25th October, 2011

On 25th October, 2011, the Reserve Bank of India officially deregulated the interest rates for savings deposits. This significant move allowed commercial banks to set their own interest rates based on market conditions and competition, rather than following a mandate from the central bank. This deregulation was a key step in the broader financial sector reforms aimed at making banking more efficient.

47. (C) I and III only

Non-Performing Assets have a detrimental impact on a bank's financials by failing to generate income while simultaneously increasing the total risk-weighted assets. Statement II is false because, under Basel II and III, NPAs are assigned higher risk weights, not lower ones. This higher weightage forces banks to allocate more capital, creating a dual negative effect of reduced earnings and increased requirements.

48. (D) 19 April, 2021

The National Bank for Financing Infrastructure and Development (NaBFID) Act, 2021, came into force on 19 April, 2021. This legislation established NaBFID as a major development financial institution tasked with addressing the long-term financing needs of India's infrastructure sector. It operates with government support and aims to catalyze private sector investment in various critical projects to drive national economic growth.

49. (B) I and III only

Treasury income is generated from trading in various financial instruments like foreign exchange and securities. Because these activities involve speculation, banks must implement strict risk management measures, including mark-to-market valuations and caps on open positions. Statement II is incorrect because banks do not perform these activities without controls; robust internal oversight is essential to prevent large losses and ensure institutional stability.

50. (C) The trustee role protects depositors, while the commercial role seeks owner profit

A bank's dual responsibility can lead to conflicting objectives. As a trustee, the bank must prioritize the safety and liquidity of depositors' funds, which often requires a conservative investment approach. However, as a commercial organization, the bank aims to maximize profits for its shareholders, which may involve engaging in higher-risk lending or trading activities. Balancing these two roles is fundamental.

51. (B) I and III only

The Indian banking sector has transitioned from a highly regulated environment toward a more market-driven and profit-oriented model. Profitability is now a central metric for evaluating bank performance. Statement II is incorrect because foreign banks have actually seen expansion and increased presence in the Indian market over recent decades. This openness is part of the broader deregulation and liberalization of the system.

52. (D) It evaluates all business streams equally by matching revenues, costs, and risks

The RAROC methodology is essential because it allows a financial institution to compare the

performance of different business lines on an equal footing. By adjusting returns for the specific risks associated with each activity, it ensures that capital is allocated efficiently. This approach helps management identify which business streams are truly profitable after considering potential losses, leading to better strategic decision-making.

53. (B) I, II, and IV only

RAROC methodology involves covering expected losses through reserves and determining unexpected losses using statistical measures like confidence levels and horizons. It also requires that risky positions generate a return sufficient to compensate for the incremental risk and allocated capital. Statement III is incorrect because risk is typically measured in terms of the variability or volatility of income, not its stability.

54. (C) A speculative activity requiring risk measures like caps on open positions

Treasury income is derived from active trading in markets like foreign exchange, equities, and bullion. Due to the speculative nature of these trades, it is vital for banks to have rigorous risk management frameworks in place. This includes setting caps on open positions and conducting regular mark-to-market valuations to monitor potential exposures and prevent catastrophic losses that could impact the bank's stability.

55. (A) I, II, and III only

Modern banking interest expenses are managed through daily product calculations for savings accounts, while current accounts remain interest-free. Term deposit rates are market-determined. Statement IV is incorrect because banks increasingly attempt to link staff costs to productivity through incentive-based packages. This approach aims to optimize operating expenses and improve overall efficiency by rewarding performance and aligning employee efforts with bank goals.

56. (A) Deregulation has successfully brought regulated interest rates to an end

Following the 1991 reforms, India successfully transitioned away from a system of strictly regulated interest rates. This deregulation has allowed banks to compete more effectively by setting rates based on market dynamics. While RBI still maintains prudential oversight, the

fundamental pillar of modern Indian banking is a market-driven approach rather than the directed investment regimes that characterized the pre-reform era.

57. (B) II, III, and IV only

Fee-based income is growing through services like internet banking, while treasury trading carries significant risks that require adequate capitalisation. Staff expenses are a key part of operating costs. Statement I is incorrect because interest income includes earnings from both lending and investments. Statement V is false as banks aim to minimize interest expenses and maximize trading income to improve overall performance.

58. (B) Interest expenses on term deposits are fixed by the RBI and not market-influenced

This statement is incorrect because the Reserve Bank of India has largely deregulated interest rates for term deposits. Banks now set these rates based on their own liquidity needs, competition, and prevailing market conditions. Other aspects of bank expenditure, such as operating costs and the push for productivity-linked staff pay, are correctly described as efforts to maintain bank efficiency.

59. (C) I, III, and IV only

Both traders achieved the same absolute profit, but the FX trader worked in a significantly more volatile market. Risk capital was calculated using a 99% Value at Risk measure. Statement II is incorrect as notional amounts were not specified as smaller for the bond trader. Statement V is false because, on a risk-adjusted basis, the bond trader performed better efficiency-wise.

60. (C) ROA and ROE are satisfactory measures for business lines because they account for risks

This statement is incorrect because Return on Assets and Return on Equity are traditional metrics that fail to account for the specific risks associated with different business activities. While they adjust for book value, they do not reflect the volatility or potential losses of various banking streams. Therefore, they are not considered satisfactory for a modern, risk-adjusted evaluation of performance today.

- 61. (B) II, III, IV, and V only**
Banking profitability and risk management depend on many integrated factors, not just three. Basel norms have provided essential standardisation for capital adequacy worldwide. Banks must continuously manage the trade-off between profitability and capital needs. Effective risk management, including optimizing fund allocation across securities and credit portfolios, has become a central and indispensable process in modern banking to ensure stability and growth.
- 62. (C) Interest paid on Savings Deposits**
Operating costs for a bank encompass non-interest expenses such as legal fees, depreciation, and communication charges. Interest paid on savings deposits is categorized specifically as an interest expense, which represents the cost of funds rather than the day-to-day cost of running the business. Distinguishing between interest expenses and operating costs is vital for accurately analyzing a bank's financial efficiency.
- 63. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A)**
Rising Non-Performing Assets directly harm bank profitability because they stop providing interest income. Furthermore, under Basel frameworks, these assets attract higher risk weightings, which forces the bank to hold more capital against them. This dual impact—lower income and higher capital requirements—inevitably reduces the return on capital, making the reason a correct and complete explanation for the bank's profitability.
- 64. (D) Global Sovereign Wealth Banks**
The Indian banking industry includes a wide variety of institutions, such as Regional Rural Banks, Small Finance Banks, and both old and new generation private sector banks. Global Sovereign Wealth Banks are not a recognized category of banks operating within the standard Indian domestic banking framework. This diverse structure ensures that different financial needs, from rural development to small-scale financing, are met.
- 65. (A) Both Assertion (A) and Reason (R) are true, and Reason (R) is the correct explanation of Assertion (A)**
ROA and ROE are inadequate for evaluating modern business performance because they focus solely on accounting book values and ignore the underlying risks. Since different banking activities have vastly different risk profiles, a simple return on assets does not tell the full story of whether a return is sufficient for the risk taken. Therefore, the reason correctly explains these traditional measures' failure.
- 66. (C) Shareholder value analysis**
Risk capital is designed to act as a buffer against potential financial shocks and must account for credit risk, operational risk, and the interactions between different risk factors. Shareholder value analysis is a separate performance evaluation tool rather than a component of the risk capital itself. Effective risk capital management ensures that a bank can remain solvent even when facing multiple simultaneous stresses.
- 67. (A) Rs. 260**
Risk Weighted Assets are calculated by multiplying the investment amount in each category by its assigned risk weight. In this portfolio, Govt. Securities contribute zero ($300 \times 0\%$), AAA customers contribute 60 ($300 \times 20\%$), and AA customers contribute 200 ($400 \times 50\%$). Summing these amounts ($0 + 60 + 200$) results in a total of Rs. 260 in risk-weighted assets, which forms the basis for requirements.
- 68. (D) By focusing on deposit mobilization under the CASA head**
Banks aim to reduce their overall interest costs by maximizing funds from Current and Savings Accounts. Current accounts are interest-free, and savings accounts typically offer lower interest rates than term deposits. A higher proportion of CASA deposits lowers the bank's cost of funds, improving its net interest margin and overall profitability. This strategy is a key component of efficiency.
- 69. (D) Accepting more risk and higher capital requirements to achieve an improved asset yield**
Shifting lending toward A-rated customers typically offers a higher yield of 12% compared to more highly rated categories. However, this

comes with a significantly higher risk weight of 100%, which increases the amount of capital the bank must maintain. This move represents a strategic trade-off where the bank pursues higher returns while knowingly accepting increased risk and capital burden.

- 70.** (C) From the distribution tail using worst-case scenarios or standard deviations

In the Earnings at Risk framework, extreme outcomes are estimated by analyzing the tail of a statistical distribution. This often involves using standard deviations or worst-case scenarios to quantify the potential impact of severe interest rate shifts on earnings. This method allows banks to understand their vulnerability to rare events, helping them set limits and manage their risk exposure effectively.

- 71.** (B) A speculative activity

Trading in foreign exchange and derivatives within a bank's treasury division is categorized as a speculative activity because it aims to profit from market price fluctuations. Unlike traditional fee-based services or non-fund intermediary activities, these trades involve taking direct market risk. Because of this speculative nature, such activities require rigorous oversight, internal controls, and risk-adjusted capital to protect the bank.

- 72.** (B) II, III, I

The 1991 Narasimham Committee report initiated the first major wave of banking reforms. This was followed years later by the deregulation of savings deposit interest rates in October 2011. Most recently, the National Bank for Financing Infrastructure and Development was established as a DFI in 2021. This sequence reflects the long-term evolution of the Indian banking sector toward modernization and specialization.

- 73.** (A) \$27.96 million

To calculate the precise risk capital for the FX trader, multiply the \$100 million notional amount by the 12% volatility and the 2.33 multiplier. The formula ($\$100\text{m} \times 0.12 \times 2.33$) yields exactly \$27.96 million. This calculation demonstrates how Value at Risk principles are applied to determine the amount of economic capital a trader needs to support the specific market risks.

- 74.** (A) P-3, Q-1, R-4, S-2

Government securities are low-yield but risk-free (6%, 0% weight). Lending to AAA customers provides moderate yields and low risk (8%, 20% weight). AA-rated customers offer higher yields with moderate risk (10%, 50% weight), while A-rated customers provide the highest yield but carry significant risk (12%, 100% weight). This matching illustrates the relationship between risk and return in bank asset allocation.

- 75.** (A) By dividing the profit by the risk capital

After determining the risk capital for a specific business line, the risk-adjusted performance is measured by dividing the profit generated by that allocated capital. This ratio allows banks to compare the efficiency of different activities. A higher ratio indicates that a business stream is providing a better return relative to the amount of risk taken, helping management make strategic decisions.

- 76.** (B) P-2, Q-1, R-4, S-3

Fee-based and treasury income are revenue streams to be maximised, while staff and interest expenses are costs to be minimised. Fee income comes from services, and treasury income comes from trading. Staff expenses are part of operating costs, and interest expenses are the costs of holding deposits. Managing these variables correctly is essential for a bank to achieve high profitability.

- 77.** (B) Earnings at Risk (EaR)

The group is advocating for the Earnings at Risk framework, which focuses on the impact of interest rate changes on cash flows and short-term earnings. This approach uses historical data and scenarios to estimate potential income fluctuations without the complex capital allocation required by RAROC. It is specifically designed to manage interest rate risk from an earnings perspective rather than value.

- 78.** (C) P-3, Q-2, R-1, S-4

Barings Bank famously collapsed due to speculative Nikkei futures trading. Bharatiya Mahila Bank was merged into the State Bank of India. Small Finance Banks are a type of differentiated bank authorized by the regulator to promote financial inclusion. NaBFID is a development financial institution focused on

infrastructure funding. These pairings highlight key institutional changes and events that have shaped modern banking.

79. (B) 1 / 2 / 2.69 / 3

In the Earnings at Risk framework, multipliers based on standard deviations are used to estimate potential losses at different confidence levels. The set 1, 2, 2.69, and 3 represents these standard deviation levels, helping banks quantify the range of possible earnings fluctuations. This statistical approach allows management to set objective risk limits and understand the severity of potential downside scenarios.

80. (D) Performance Measurement - Adjustment of performance for the risk capital

In the RAROC framework, performance measurement specifically refers to adjusting the earned profits of a business stream against the economic capital allocated to it. This provides a risk-adjusted view of success. Other components like risk management involve choosing confidence levels, while capital allocation is based on those risk measures. Correctly matching these components is essential for evaluating diverse banking operations.

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